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10 *& Co., L.P., Zazove Associates, LLC, CNH Partners,*  
*LLC, Advent Capital Management, LLC, AQR Capital*  
11 *Management, LLC, and HFR CA Lazard Rathmore*  
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18 UNITED STATES DISTRICT COURT

19 DISTRICT OF NEVADA

20 OAKTREE CAPITAL MANAGEMENT,  
21 L.P., on behalf of its managed funds and  
accounts, LAZARD ASSET  
22 MANAGEMENT LLC, on behalf of its  
managed funds and accounts, ANGELO,  
23 GORDON & CO., L.P., on behalf of one of  
its managed funds, ZAZOVE ASSOCIATES  
24 LLC, on behalf of certain of its managed  
funds and accounts, CNH PARTNERS,  
25 LLC, on behalf of its managed funds,  
ADVENT CAPITAL MANAGEMENT,  
26 LLC, on behalf of one of its managed funds,  
AQR CAPITAL MANAGEMENT, LLC, on  
27 behalf of its managed funds, HFR CA  
LAZARD RATHMORE MASTER TRUST,  
28 and DELAWARE PUBLIC EMPLOYEES'  
RETIREMENT SYSTEM,

No. 2:12-CV-00956-JCM(GWF)

**JURY TRIAL DEMANDED**

1  
2 Plaintiffs,

3 -against-

4 KPMG, a Hong Kong partnership, KPMG  
5 INTERNATIONAL COOPERATIVE,  
6 KPMG LLP, HANSEN, BARNETT &  
7 MAXWELL, P.C., and MORGAN  
8 STANLEY & CO.,

9 Defendants.

10  
11 **CONSOLIDATED COMPLAINT**

12 1. Oaktree Capital Management, L.P., on behalf of its managed funds  
13 and accounts; Lazard Asset Management LLC, on behalf of its managed funds and  
14 accounts; Angelo, Gordon & Co., L.P., on behalf of one of its managed funds;  
15 Zazove Associates LLC, on behalf of certain of its managed funds and accounts;  
16 CNH Partners, LLC, on behalf of its managed funds; Advent Capital Management,  
17 LLC, on behalf of one of its managed funds; AQR Capital Management, LLC, on  
18 behalf of its managed funds; HFR CA Lazard Rathmore Master Trust; and  
19 Delaware Public Employees' Retirement System (collectively, "Plaintiffs"), by  
20 their undersigned attorneys, allege the following upon personal knowledge as to  
21 themselves individually and their own acts and upon information and belief as to  
22 all other matters. Plaintiffs' information and belief is based on their investigation  
23 (made by and through their attorneys), which included, among other things, review  
24 and analysis of: (1) filings by ShengdaTech, Inc. ("ShengdaTech" or the  
25 "Company") with the Securities and Exchange Commission (the "SEC"); (2) press  
26 releases published by ShengdaTech; (3) the offering memorandum (the "6.0%  
27 Notes Offering Memorandum") ShengdaTech disseminated to qualified  
28 institutional investors in connection with its offering (the "6.0% Notes Offering")  
of 6.0% Convertible Senior Notes due 2018 (the "6.0% Notes"); (4) the offering  
memorandum (the "6.5% Notes Offering Memorandum") ShengdaTech  
disseminated to qualified institutional investors in connection with its offering (the

1 “6.5% Notes Offering”) of 6.5% Senior Convertible Notes Due 2015 (the “6.5%  
2 Notes”); (5) filings made in connection with ShengdaTech’s bankruptcy  
3 proceeding, *In re ShengdaTech, Inc.*, Case No. BK-11-52649 (Bankr. D. Nev.);  
4 and (6) newspaper and magazine articles (and other media coverage) regarding  
5 ShengdaTech, its business, and/or the Defendants (defined below). Many of the  
6 facts supporting the allegations contained herein are known only to the Defendants  
7 or are exclusively within their custody and/or control. Plaintiffs believe that  
8 further substantial evidentiary support will exist for the allegations in this  
9 Complaint after a reasonable opportunity for discovery.

10 **I. NATURE OF THE CASE**

11 2. ShengdaTech – a once-promising participant in the burgeoning nano-  
12 precipitated calcium carbonate (“NPCC”) market – has spiraled into bankruptcy  
13 and has been revealed to have foisted the 6.0% Notes and the 6.5% Notes  
14 (collectively, the “Notes”) on the investing public based upon falsified financial  
15 results. Between May 15, 2008 and May 5, 2011 (the “Loss Period”), Defendants  
16 made a number of materially false and misleading statements concerning  
17 ShengdaTech’s financial results and, in the case of the Auditor Defendants  
18 (defined below), the strength of its internal controls. Among other things,  
19 ShengdaTech’s financial statements materially inflated the Company’s sales and  
20 reflected ownership of assets that did not, in fact, exist.

21 3. Plaintiffs relied on Defendants’ false and misleading statements in  
22 collectively purchasing over \$94 million of the Company’s Notes during the Loss  
23 Period, over \$76 million of which they continued to hold through the end of the  
24 Loss Period. Plaintiffs’ purchases included \$250,000 par amount of 6.0% Notes in  
25 the 6.0% Notes Offering, over \$56 million par amount of 6.5% Notes in the 6.5%  
26 Notes Offering, and over \$38 million par amount of secondary market purchases of  
27 both series of Notes. When the truth about ShengdaTech began to be revealed, the  
28 funds and accounts for whom Plaintiffs purchased the Notes suffered substantial

1 damages as the Company collapsed into bankruptcy and defaulted on the Notes.

2 4. Plaintiffs bring this action against ShengdaTech's former auditors –  
3 KPMG, a Hong Kong partnership ("KPMG HK"), KPMG International  
4 Cooperative ("KPMG International"), and KPMG LLP ("KPMG USA")  
5 (collectively, "KPMG") and Hansen, Barnett & Maxwell, P.C. ("Hansen")  
6 (together, the "Auditor Defendants") – and against the investment bank that  
7 underwrote the 6.5% Notes Offering and sold these Notes to the investing public,  
8 Morgan Stanley & Co. ("Morgan Stanley").<sup>1</sup>

9 5. Hansen audited ShengdaTech's financial statements for the fiscal year  
10 ended December 31, 2007 (the "2007 Financial Statements"), and consented to the  
11 inclusion of its unqualified audit opinions on the 2007 Financial Statements in (1)  
12 the 6.0% Notes Offering Memorandum, (2) the 6.5% Notes Offering  
13 Memorandum, (3) the Company's amended annual report on Form 10-K/A for the  
14 year ended December 31, 2007, filed with the SEC on May 15, 2008 (the "2007  
15 10-K/A"), (4) the Company's annual report on Form 10-K for the fiscal year ended  
16 December 31, 2008, filed with the SEC on April 1, 2009 (the "2008 10-K"), and  
17 (5) the Company's annual report on Form 10-K for the year ended December 31,  
18 2009, filed with the SEC on March 15, 2010 (the "2009 10-K"), and an amendment  
19 thereto filed on September 15, 2010 (the "2009 10-K/A").

20 6. KPMG HK audited the Company's financial statements for the fiscal  
21 years ended December 31, 2008 (the "2008 Financial Statements") and December  
22 31, 2009 (the "2009 Financial Statements"), and consented to the inclusion of its  
23 unqualified audit reports on those financial statements in (1) the 6.5% Notes  
24 Offering Memorandum, (2) the 2008 10-K, and (3) the 2009 10-K and 2009 10-  
25 K/A. KPMG HK's affiliation with KPMG International added to KPMG HK's

26 <sup>1</sup> Plaintiffs CNH (defined below) and AQR (defined below) are not asserting any  
27 claims against Morgan Stanley. While reference may be made herein to  
28 "Plaintiffs' claims against Morgan Stanley" or the like, such references are for ease  
of reference only and are not to be construed as implying that CNH or AQR are  
asserting any claims against Morgan Stanley.

1 reputational prestige, and KPMG HK's ability to consult with KPMG USA as a  
2 result of their common affiliations with KPMG International positioned KPMG  
3 HK to secure its retention as ShengdaTech's auditor. Because KPMG HK's audits  
4 required application of United States accounting rules pursuant to SEC regulations,  
5 KPMG USA reviewed and supervised the audit work KPMG HK performed for  
6 ShengdaTech, and had ultimate authority over whether KPMG HK's audit reports  
7 would be included in ShengdaTech's United States SEC filings and offering  
8 memoranda. KPMG International facilitated communication between KPMG HK  
9 and KPMG USA concerning the audits.

10 7. Morgan Stanley underwrote and served as an initial purchaser for  
11 ShengdaTech's 6.5% Notes Offering and acted as sole bookrunner for that  
12 Offering in exchange for substantial fees. Morgan Stanley purchased from  
13 ShengdaTech and immediately resold to investors \$109,200,000 of the total  
14 \$130,000,000 of 6.5% Notes offered for sale in the 6.5% Notes Offering. Pursuant  
15 to the 6.5% Notes Purchase Agreement, ShengdaTech sold these 6.5% Notes to  
16 Morgan Stanley for "a purchase price of 95.0% of the principal amount."  
17 Accordingly, Morgan Stanley earned \$5,460,000 – 5% of the \$109,200,000 of  
18 6.5% Notes that it purchased from ShengdaTech and immediately resold to  
19 investors – in connection with the 6.5% Notes Offering.

20 8. Relying upon ShengdaTech's audited and unaudited financial  
21 statements, Hansen's and KPMG HK's unqualified audit opinions on  
22 ShengdaTech's audited financial statements, and (with respect to the 6.5% Notes)  
23 the imprimatur of legitimacy lent to the 6.5% Notes Offering and to the statements  
24 contained in the 6.5% Notes Offering Memorandum by Morgan Stanley's  
25 involvement, Plaintiffs collectively invested over \$22 million in the 6.0% Notes  
26 (both in the 6.0% Notes Offering and in the secondary market) and approximately  
27 \$73 million in the 6.5% Notes (both in the 6.5% Notes Offering and in the  
28 secondary market). Subsequently, and while Plaintiffs still held these Notes,

1 ShengdaTech announced on March 15, 2011, that KPMG had uncovered  
2 “potentially serious discrepancies and unexplained issues” during the course of its  
3 audit of the Company’s financial statements for the year ended December 31, 2010  
4 (the “2010 Financial Statements”). The nature of these “potentially serious  
5 discrepancies and unexplained issues” was not disclosed at that time.

6 9. ShengdaTech’s board of directors formed a committee (the “Special  
7 Committee”) to investigate the issues KPMG had identified, and appointed the  
8 members of the Company’s audit committee to serve on the Special Committee.  
9 As Plaintiffs and other investors would learn many months later, ShengdaTech  
10 management thwarted the Special Committee’s efforts by, *inter alia*, refusing to  
11 respond to information requests and interfering with the Special Committee’s  
12 attempts to obtain confirmation of the Company’s bank balances with a number of  
13 Chinese banks where the Company claimed to have deposited funds.

14 10. On May 5, 2011, the Company filed a Form 8-K with the SEC that  
15 provided additional detail concerning the “potentially serious discrepancies and  
16 unexplained issues” with ShengdaTech’s financial records, revealing that they  
17 included issues relating to (1) the Company’s bank balances, (2) transactions with  
18 the Company’s major suppliers, (3) value-added tax (“VAT”) invoices and  
19 payments, (4) sales and payments for sales by third parties, (5) sales to the  
20 Company’s second largest customer, (6) discrepancies between the results of  
21 KPMG’s direct calls to customers and confirmations returned by mail, and (7)  
22 concerns raised when KPMG attempted to directly confirm customer sales and  
23 accounts receivable.

24 11. The Company also disclosed in its May 5, 2011 filing that KPMG was  
25 disclaiming its unqualified audit opinions on the Company’s 2008 and 2009  
26 Financial Statements and its representations that the Company had adequate  
27 internal controls over financial reporting during the fiscal year ended December  
28 31, 2009. Specifically, ShengdaTech disclosed that KPMG had informed the



1 Company that “disclosures should be made and action should be taken to prevent  
2 future reliance on [KPMG’s] previously issued audit reports related to the  
3 consolidated balance sheets of [ShengdaTech] and its subsidiaries as of December  
4 31, 2008 and 2009, and the related consolidated statements of income,  
5 shareholders’ equity and comprehensive income, and cash flows for the years then  
6 ended and the effectiveness of internal control over financial reporting as of  
7 December 31, 2008 and 2009.”

8 12. KPMG’s swift retraction of its audit opinions for both of the years in  
9 which it audited ShengdaTech, in conjunction with the steadfast efforts of  
10 ShengdaTech’s management to block the Special Committee’s investigation,  
11 indicate that fraud had been rampant at the Company for quite some time, and that  
12 the auditors had turned a blind eye to this financial fraud ever since the Company  
13 went public.

14 13. The Auditor Defendants, charged with the responsibility as the  
15 Company’s outside auditors to closely scrutinize the Company’s financial records  
16 in search of signs of fraud or misstatements, were, at a minimum, negligent in  
17 failing to uncover the fraud and in issuing unqualified audit opinions. Morgan  
18 Stanley, charged with the duty to make a reasonable investigation into the  
19 statements made in the 6.5% Notes Offering Memorandum upon which it knew  
20 Plaintiffs would rely in deciding to purchase the 6.5% Notes, was also, at a  
21 minimum, negligent in failing to uncover the fraud – particularly with regard to the  
22 unaudited financial statements and other financial information in the 6.5% Notes  
23 Offering Memorandum that Morgan Stanley knew had not been audited by the  
24 Auditor Defendants. Defendants’ negligence allowed the Notes to enter the  
25 market, and created the false impression that ShengdaTech had the financial  
26 wherewithal to repay the Notes with interest.

27 14. Plaintiffs relied on the 2007, 2008 and 2009 Financial Statements, on  
28 the Auditor Defendants’ unqualified audit opinions thereon, and on the unaudited

1 financial statements and other information contained in the 6.5% Notes Offering  
2 Memorandum, the contents of which were blessed by Morgan Stanley, when  
3 deciding to purchase Notes during the Loss Period. When the truth began to be  
4 revealed, the trading prices of the Notes plummeted, and ShengdaTech soon  
5 defaulted on the Notes. Accordingly, Defendants' negligence has caused  
6 substantial harm to the funds and accounts on whose behalf Plaintiffs purchased  
7 the Notes.

## 8 **II. JURISDICTION AND VENUE**

9 15. The claims herein arise under Sections 18 and 20(a) of the Securities  
10 Exchange Act of 1934 (the "Exchange Act"), 15 U.S.C. § 78r and 78t(a); common  
11 law; the California Corporations Code; and the Connecticut Uniform Securities  
12 Act.

13 16. This Court has jurisdiction over this matter and over the Defendants  
14 pursuant to Section 27 of the Exchange Act, 15 U.S.C. § 78aa; 28 U.S.C. § 1331;  
15 and principles of supplemental jurisdiction, 28 U.S.C. § 1367.

16 17. Venue is proper in this District pursuant to Section 27 of the  
17 Exchange Act, 15 U.S.C. § 78aa; 28 U.S.C. § 1391(b)(2); and 28 U.S.C. § 1391(c).  
18 Plaintiff Zazove Associates LLC is located in this District, and ShengdaTech's  
19 bankruptcy proceedings were proceeding in this District at the time this suit was  
20 filed. Additionally, events giving rise to the claims at issue occurred in this  
21 District, as the Defendants' false and misleading statements were disseminated to  
22 investors in this District, including Plaintiff Zazove. Defendants are subject to  
23 personal jurisdiction in this District because they have (or had) substantial contacts  
24 with this District by virtue of having served as auditors and underwriters for  
25 ShengdaTech, a Nevada corporation, and, with respect to the Auditor Defendants,  
26 by virtue of having consented to the inclusion of their audit reports in  
27 ShengdaTech's SEC filings and offering documents. Furthermore, KPMG USA  
28 and Hansen regularly do business within this District.



### **III. PARTIES**

#### **A. Plaintiffs**

18. Plaintiff Oaktree Capital Management, L.P., an asset management company headquartered in California, brings this action on behalf of eight investment funds that it manages and for which it purchased Notes during the Loss Period, and on behalf of sixteen clients on whose behalf it purchased Notes during the Loss Period and from whom it has received valid assignments of claims pertaining to the Notes (collectively, “Oaktree”). During the Loss Period, Oaktree purchased over \$15,000,000 par amount of 6.5% Notes from Morgan Stanley in the 6.5% Notes Offering and over \$5,900,000 par amount of 6.5% Notes in the secondary market, which Oaktree continued to hold at the end of the Loss Period. Oaktree subsequently sold some of the 6.5% Notes at a substantial discount to par, but continues to hold over \$13,200,000 par amount of 6.5% Notes, which are now in default.

19. Plaintiff Lazard Asset Management LLC, an asset management company headquartered in New York, brings this action on behalf of an investment fund that it manages and for which it purchased Notes during the Loss Period, and on behalf of four clients on whose behalf it purchased Notes during the Loss Period and from whom it has received valid assignments of claims pertaining to the Notes (collectively, “LAM”). During the Loss Period, LAM purchased \$9,850,000 par amount of 6.5% Notes from Morgan Stanley in the 6.5% Notes Offering, \$14,239,000 par amount of 6.0% Notes in the secondary market, and \$4,425,000 par amount of 6.5% Notes in the secondary market. At the end of the Loss Period, LAM continued to hold \$2,090,000 par amount of 6.0% Notes and \$12,750,000 par amount of 6.5% Notes, which LAM still holds and are now in default.

20. Plaintiff Angelo, Gordon & Co., an investment advisory firm based in New York, brings this action on behalf of a fund that it manages and for which it purchased Notes during the Loss Period (collectively, “Angelo Gordon”). During

1 the Loss Period, Angelo Gordon purchased \$10,000,000 par amount of 6.5% Notes  
2 from Morgan Stanley in the 6.5% Notes Offering and \$5,000,000 par amount of  
3 6.5% Notes in the secondary market. Angelo Gordon continues to hold these 6.5%  
4 Notes, which are now in default.

5 21. Plaintiff Zazove Associates LLC, an investment advisory firm based  
6 in Nevada, brings this action on behalf of two managed funds for which it  
7 purchased Notes during the Loss Period, and on behalf of six clients on whose  
8 behalf it purchased Notes during the Loss Period and from whom it has received  
9 valid assignments of claims pertaining to the Notes (collectively, “Zazove”). One  
10 of the clients on whose behalf Zazove Associates LLC is bringing this action is  
11 also one of the clients on whose behalf Oaktree Capital Management, L.P. is  
12 bringing this action, albeit on behalf of a different account owned by that client.  
13 During the Loss Period, Zazove purchased \$10,000,000 par amount of 6.5% Notes  
14 from Morgan Stanley in the 6.5% Notes Offering. Zazove continues to hold these  
15 6.5% Notes, which are now in default.

16 22. Plaintiff CNH Partners LLC, an investment management company  
17 based in Connecticut, brings this action against Hansen and the KPMG entities on  
18 behalf of two funds that it manages or co-manages and for which it purchased  
19 Notes during the Loss Period (collectively, “CNH”). During the Loss Period, CNH  
20 purchased \$250,000 par amount of 6.0% Notes in the 6.0% Notes Offering,  
21 \$1,800,000 par amount of 6.0% Notes in the secondary market, and \$3,300,000 par  
22 amount of 6.5% Notes in the 6.5% Notes Offering. CNH continues to hold these  
23 6.0% Notes and 6.5% Notes, which are now in default. CNH is not asserting any  
24 claim herein against Morgan Stanley.

25 23. Plaintiff Advent Capital Management LLC, an investment advisory  
26 firm based in New York, brings this action on behalf of a closed-end fund that it  
27 manages and for which it purchased Notes during the Loss Period (collectively,  
28 “Advent”). During the Loss Period, Advent purchased \$2,840,000 par amount of

1 6.5% Notes from Morgan Stanley in the 6.5% Notes Offering. Advent continues  
2 to hold these 6.5% Notes, which are now in default.

3 24. Plaintiff AQR Capital Management, LLC, an investment management  
4 company based in Connecticut, brings this action against Hansen and the KPMG  
5 entities on behalf of five funds that it manages or co-manages and for which it  
6 purchased Notes during the Loss Period (collectively, "AQR"). During the Loss  
7 Period, AQR purchased \$2,075,000 par amount of 6.0% Notes in the secondary  
8 market, \$1,700,000 par amount of 6.5% Notes in the 6.5% Notes Offering, and  
9 \$500,000 par amount of 6.5% Notes in the secondary market. AQR continues to  
10 hold these 6.0% Notes and 6.5% Notes, which are now in default. AQR is not  
11 asserting any claim herein against Morgan Stanley.

12 25. Plaintiff HFR CA Lazard Rathmore Master Trust ("HFR") is a  
13 Bermuda unit trust whose investments are managed by Plaintiff Lazard Asset  
14 Management LLC, and on whose behalf Lazard Asset Management LLC  
15 purchased Notes during the Loss Period. During the Los Period, Lazard Asset  
16 Management LLC purchased on behalf of HFR \$1,390,000 par amount of 6.5%  
17 Notes from Morgan Stanley in the 6.5% Notes Offering, \$3,661,000 par amount of  
18 6.0% Notes in the secondary market, and \$440,000 par amount of 6.5% Notes in  
19 the secondary market. HFR continues to hold \$365,000 par amount of 6.0% Notes  
20 and \$1,490,000 par amount of 6.5% Notes, which are now in default.

21 26. Plaintiff Delaware Public Employees Retirement System ("DPERS")  
22 is a system created by Title 29, Chapter 83 of the Delaware Code to hold and  
23 invest the retirement funds of public employees of the State of Delaware. DPERS  
24 is administered by the State of Delaware Board of Pension Trustees who are  
25 statutorily authorized to administer the retirement system and invest, on a  
26 commingled basis, the trust fund monies of DPERS. During the Loss Period,  
27 Oaktree Capital Management, L.P. was DPERS' investment manager with  
28 authority to make investments on behalf of DPERS, and as such Oaktree Capital

1 Management, L.P. purchased \$2,520,000 par value of the 6.5% Notes for DPERS  
2 from Morgan Stanley in the 6.5% Notes Offering. After the end of the Loss  
3 Period, on June 22, 2011, DPERS sold \$845,000 par value of the Notes, realizing a  
4 loss of \$678,112.50. DPERS has sustained a substantial unrealized loss on the  
5 \$1,675,000 par value of the 6.5% Notes it continues to hold.

6 27. Plaintiffs collectively are seeking damages in this action on behalf of  
7 fifty (50) or fewer persons.

8 **B. Defendants**

9 28. Defendant KPMG International Cooperative (“KPMG International”)  
10 is a Swiss entity that does not provide audit services to clients, but instead  
11 coordinates the global network of professional KPMG-affiliate firms that do  
12 provide audit, tax and advisory services to clients in 150 countries, with 138,000  
13 people working in member firms around the world. KPMG International and its  
14 member and network firms market themselves worldwide under the brand name  
15 “KPMG.” All KPMG member firms commit to abide by a common set of KPMG  
16 values that are established by the Global Board, which is KPMG International’s  
17 principal oversight and governance body. The Global Board Council, which  
18 includes representation of 54 member firms, focuses on high-level governance  
19 tasks and facilitates discussion with and between member firms. KPMG  
20 International is dominated and controlled by KPMG USA.

21 29. Defendant KPMG, a Hong Kong Partnership (“KPMG HK”) is a  
22 member firm of the KPMG network of member firms affiliated with Defendant  
23 KPMG International. KPMG HK is the entity that signed KPMG’s audit reports  
24 on the Company’s 2008 and 2009 Financial Statements. KPMG HK consented to  
25 the inclusion of these audit reports in the 6.5% Notes Offering Memorandum, the  
26 2008 10-K, and the 2009 10-K and 2009 10-K/A.

27 30. Defendant KPMG LLP (“KPMG USA”) is a United States-based  
28 audit, tax and advisory services firm, which operates from 87 offices with more

1 than 23,000 employees and partners throughout the United States. KPMG USA is  
2 the United States member firm of the KPMG network of member firms affiliated  
3 with KPMG International. KPMG USA supervised and reviewed the audit work  
4 that KPMG HK performed for ShengdaTech, and had ultimate authority over  
5 whether KPMG HK's audit reports would be included in the SEC filings and  
6 offering memoranda of ShengdaTech.

7 31. Defendant KPMG HK was dominated and controlled by Defendants  
8 KPMG International and KPMG USA in connection with its audits of  
9 ShengdaTech. Information regarding the exact relationship among these entities is  
10 within the exclusive control of these Defendants and discovery will therefore  
11 demonstrate the full extent to which these entities act for and answer for each  
12 other.

13 32. Defendant Hansen, Barnett & Maxwell, P.C. ("Hansen") provides  
14 auditing, assurance, tax, client accounting and consulting services for a wide range  
15 of clients. Hansen is headquartered in Salt Lake City, Utah. Hansen audited  
16 ShengdaTech's 2007 Financial Statements and consented to the inclusion of its  
17 unqualified audit reports on the 2007 Financial Statements in the 6.0% Notes  
18 Offering Memorandum, the 6.5% Notes Offering Memorandum, the 2007 10-K/A,  
19 the 2008 10-K, and the 2009 10-K and 2009 10-K/A.

20 33. Defendant Morgan Stanley & Co. ("Morgan Stanley") is a global  
21 financial services firm that, through its subsidiaries and affiliates, provides  
22 products and services to a large and diversified group of clients and customers.  
23 Morgan Stanley underwrote and served as an initial purchaser for ShengdaTech's  
24 6.5% Note Offering, and acted as sole bookrunner for that Offering. As such,  
25 Morgan Stanley purchased and immediately resold to investors \$109,200,000 of  
26 the total \$130,000,000 of 6.5% Notes offered for sale in the 6.5% Notes Offering.  
27 As part of its duties as an underwriter, Morgan Stanley was required to conduct,  
28 prior to the 6.5% Notes Offering, a reasonable investigation to ensure that the 6.5%

1 Notes Offering Memorandum contained no misstatement or omission of material  
2 fact.

3 **IV. RELEVANT NON-PARTIES**

4 34. ShengdaTech was, prior to its bankruptcy, a Nevada corporation with  
5 its principal place of business in China. ShengdaTech manufactured a specialty  
6 additive known as nano-precipitated calcium carbonate (“NPCC”). NPCC is used  
7 in a variety of products to enhance their durability and efficiency and is widely  
8 applied in the paint, paper, plastic and rubber industries and used for building  
9 materials such as PVC. ShengdaTech conducted its manufacturing operations  
10 through several affiliated companies in China (the “PRC Companies”).<sup>2</sup> The PRC  
11 Companies are owned by Faith Bloom Limited (“Faith Bloom”), a wholly-owned  
12 subsidiary of ShengdaTech that is organized under the laws of the British Virgin  
13 Islands.

14 35. Xiangzhi Chen (“Chen”) was ShengdaTech’s President and Chief  
15 Executive Officer and a member of its board of directors from March 31, 2006  
16 through its bankruptcy. Chen was also the Company’s largest shareholder, owning  
17 over 42.25% of ShengdaTech’s outstanding shares. Chen was ousted from his  
18 position at ShengdaTech on August 19, 2011, after he took deliberate steps to  
19 thwart the Special Committee’s internal investigation into financial improprieties  
20 at the Company.

21 36. Anhui Guo (“Guo”) was, at all relevant times prior to her resignation  
22 on April 29, 2011, the Company’s Chief Operating Officer, acting Chief Financial  
23 Officer, and a member of the Board of Directors.

24  
25  
26  
27 <sup>2</sup> The PRC Companies are Shandong Haize Nanomaterials Co., Ltd., Shandong  
28 Bangsheng Chemical Co., Ltd., Shaanxi Haize Nanomaterials Co., Ltd., Zibo  
Jiaze Nanomaterials Co., Ltd., and Anhui Yuanzhong Nanomaterials Co., Ltd.



1 **V. FACTUAL ALLEGATIONS**

2 **A. Historical Background Of ShengdaTech & The Notes Offerings**

3 37. The company known as ShengdaTech was formed by a “reverse  
4 merger” with a United States shell company, Zeolite Exploration Company  
5 (“Zeolite”), in March 2006. To effectuate the reverse merger, on March 31, 2006,  
6 ShengdaTech consummated a share exchange pursuant to a Securities Purchase  
7 Agreement and Plan of Reorganization with Faith Bloom, whereby ShengdaTech  
8 acquired all of the issued and outstanding capital stock of Faith Bloom in exchange  
9 for 50,957,603 shares of ShengdaTech common stock. ShengdaTech went public  
10 in late March 2006 and its stock began trading on the NASDAQ in early 2007.

11 38. To finance its operations, ShengdaTech conducted two private  
12 offerings of debt securities targeted to “qualified institutional buyers” as defined in  
13 Rule 144A of the Securities Act of 1933 (the “Securities Act”).

14 39. First, in 2008, ShengdaTech conducted the 6.0% Note Offering,  
15 pursuant to which Plaintiff CNH and other qualified institutional buyers purchased  
16 \$115,000,000 of 6.0% Notes. The 6.0% Notes Offering was conducted pursuant to  
17 the 6.0% Notes Offering Memorandum, which included the Company’s 2007  
18 Financial Statements. Hansen issued an unqualified audit opinion on the  
19 Company’s 2007 Financial Statements, stating that they fairly presented the  
20 Company’s financial condition and the results of its operations in accordance with  
21 generally accepted accounting principles (“GAAP”) and that the Company  
22 maintained effective internal controls over financial reporting. Hansen consented  
23 to the inclusion of its unqualified audit opinion on the 2007 Financial Statements in  
24 the 6.0% Notes Offering Memorandum. Interest on the 6.0% Notes was payable  
25 semiannually on June 1 and December 1. The 6.0% Notes were convertible into  
26 shares of ShengdaTech common stock at an initial conversion rate of 100.6036  
27 shares per \$1,000 principal amount of the 6.0% Notes, subject to adjustment.

28 40. Second, on December 10, 2010, ShengdaTech announced that it had

1 entered into a purchase agreement with Morgan Stanley relating to an offering of  
2 \$130,000,000 of 6.5% Notes. The completion of the 6.5% Notes Offering was  
3 conditioned upon a certain amount of the 6.0% Notes being repurchased by  
4 ShengdaTech and surrendered to the 6.0% Notes' trustee for cancellation such that  
5 at least 75% of the original issuance amount of the 6.0% Notes was no longer  
6 outstanding. Approximately \$67.2 million of the net proceeds of the 6.5% Notes  
7 Offering were to be used to repurchase a portion of the 6.0% Notes. On December  
8 15, 2010, ShengdaTech announced that it had completed the 6.5% Notes Offering.  
9 The 6.5% Notes were convertible into shares of ShengdaTech common stock at an  
10 initial conversion rate of 164.6904 shares per \$1,000 principal amount of 6.5%  
11 Notes, subject to adjustment. Holders of 6.5% Notes had the right to require  
12 ShengdaTech to repurchase, for cash, all or any portion of their 6.5% Notes on  
13 December 15, 2013 at a price equal to 100% of the principal amount of the 6.5%  
14 Notes to be purchased, plus accrued and unpaid interest.

15 41. The 6.5% Notes Offering was underwritten by Morgan Stanley  
16 pursuant to the 6.5% Notes Offering Memorandum, which included the  
17 Company's 2007, 2008, and 2009 Financial Statements. The 2007 Financial  
18 Statements were audited by Hansen, and the 2008 and 2009 Financial Statements  
19 were audited by KPMG HK. Hansen and KPMG HK issued unqualified audit  
20 opinions on the respective Financial Statements that they audited, stating, *inter*  
21 *alia*, that those Financial Statements fairly presented the Company's financial  
22 condition and the results of its operations in accordance with GAAP. With the  
23 consent of Hansen and KPMG HK, their unqualified audit opinions on the 2007,  
24 2008 and 2009 Financial Statements were included in the 6.5% Notes Offering  
25 Memorandum.

26 42. Because ShengdaTech was required to file its financial statements  
27 with the SEC, KPMG's United States member firm – KPMG USA – reviewed and  
28 supervised KPMG HK's audits of ShengdaTech's 2008 and 2009 Financial

1 Statements to ensure that these audits were conducted in accordance with United  
2 States Generally Accepted Auditing Standards (“GAAS”) and that ShengdaTech’s  
3 2008 and 2009 Financial Statements accurately presented the Company’s financial  
4 condition and the results of its operations in accordance with United States GAAP.  
5 KPMG USA reviewed and approved the issuance of KPMG HK’s unqualified  
6 audit opinions on the 2008 and 2009 Financial Statements, and approved their  
7 inclusion in the 6.5% Notes Offering Memorandum.

8 43. In addition to the Company’s audited financial statements, the 6.5%  
9 Notes Offering Memorandum included unaudited financial information, which the  
10 investing public, including Plaintiffs, understood to have been reviewed by  
11 Morgan Stanley as the lead underwriter of the 6.5% Notes Offering in order to  
12 ensure that the 6.5% Notes Offering Memorandum did not include any material  
13 misstatements or omit any material facts.

14 44. Each of the Plaintiffs purchased 6.5% Notes in the 6.5% Notes  
15 Offering, and some of the Plaintiffs subsequently purchased additional 6.5% Notes  
16 in the secondary market. All of these purchases were made in reliance on the  
17 financial statements and other information, including the Auditor Defendants’  
18 unqualified audit opinions, in the 6.5% Notes Offering Memorandum and in  
19 ShengdaTech’s other SEC filings during the Loss Period.

20 **B. ShengdaTech’s Default On The Notes**

21 45. ShengdaTech has turned out to have been a sham. ShengdaTech  
22 duped investors into buying over \$200 million in Notes by publicly reporting  
23 strong financial results, but later disclosures have demonstrated that those financial  
24 results were a complete fantasy. ShengdaTech management utterly misrepresented  
25 the value and, indeed, the existence of material assets that were recorded on the  
26 Company’s balance sheet, and materially overstated the Company’s sales by  
27 recording unsupported and fictitious transactions. The Company’s auditors and  
28 lead underwriter failed to detect this rather blatant and rudimentary fraud.

1           46. On March 15, 2011, ShengdaTech stunned the market with an  
2 announcement that its board of directors had appointed a Special Committee to  
3 investigate “potentially serious discrepancies and unexplained issues relating to the  
4 Company’s and its subsidiaries’ financial records identified by [KPMG]” in the  
5 course of KPMG’s examination of the Company’s 2010 Financial Statements, and  
6 that the Special Committee had retained O’Melveny & Myers, LLP (“O’Melveny”)  
7 to conduct an independent investigation into these issues. According to an August  
8 2011 bankruptcy court filing by ShengdaTech, the issues that KPMG identified  
9 included the existence of undisclosed related party transactions and the inability to  
10 confirm sales amounts, sales terms, and outstanding balances. Although not  
11 publicly disclosed until March 15, 2011, these discrepancies and issues had existed  
12 in prior years as well, but had not been uncovered until ShengdaTech’s audit  
13 committee asked KPMG to perform additional audit testing during its audit of the  
14 2010 Financial Statements, beyond what it had done in prior years’ audits.

15           47. Also on March 15, 2011, ShengdaTech announced that the SEC had  
16 been informed of the internal investigation, and that the Company would not  
17 timely file its 2010 Form 10-K. In response to this announcement, the NASDAQ  
18 suspended trading in the Company’s shares.

19           48. Although not publicly disclosed until April 29, 2011, (i) KPMG  
20 informed the Company on April 19, 2011 that ShengdaTech’s senior management  
21 had not taken timely and appropriate remedial action with respect to the  
22 discrepancies and issues that KPMG had identified in the course of its 2010 audit,  
23 and (ii) NASDAQ informed the Company on April 20, 2011 that its shares would  
24 be delisted.

25           49. On April 29, 2011, the Company issued a press release disclosing  
26 NASDAQ’s April 20, 2011 decision to delist ShengdaTech’s shares. The press  
27 release stated that the April 20, 2011 letter from the NASDAQ Listing  
28 Qualifications Department had cited the following criteria in support of its decision

1 to delist ShengdaTech:

2 (1) public interest concerns under Nasdaq Listing Rule  
3 5101 raised by the *serious accounting and operational*  
4 *issues uncovered by KPMG, the Company's*  
5 *independent registered public accounting firm; the*  
6 *deliberate and ongoing efforts of the Company's Chief*  
7 *Executive Officer and Acting Chief Financial Officer,*  
8 *Mr. Xiang Zhi Chen and Ms. Anhui Guo, respectively,*  
9 *to obstruct an internal investigation into these matters;*  
10 *the Company's failure to promptly disclose material*  
11 *information related to that investigation; and the*  
12 *Company's violation of the rules setting forth the*  
13 *responsibilities and authority of the Audit Committee;*

14 (2) the Company's failure to make prompt public  
15 disclosure of material developments relating to the  
16 investigation, as required by Nasdaq Listing Rule  
17 5250(b)(1) and IM-5250-1;

18 (3) the Company's violations of Nasdaq Listing Rule  
19 5605(c)(3) and IM-5605 as well as the statutory  
20 responsibilities and authority of the Audit Committee set  
21 forth in Section 10A(m)(2) of the Securities and  
22 Exchange Act of 1934 caused by the obstructive conduct  
23 of the Company's executive management, including  
24 failure to pay for advisors engaged to assist with the  
25 internal investigation by the special committee of the  
26 Board of Directors of the Company; and

27 (4) the Company's failures to timely file with the  
28 Securities and Exchange Commission its Annual Report  
on Form 10-K for the period ended December 31, 2010,  
as required by Nasdaq Listing Rule 5250(c)(1), and to  
present a definitive plan that demonstrates its ability to  
regain compliance within the time period permitted under  
Nasdaq's Listing Rules.

(emphasis added).

50. Also on April 29, 2011, ShengdaTech announced that Guo had  
resigned, effective immediately.

1           51. On May 5, 2011, ShengdaTech filed another Form 8-K with the SEC  
2 in which it announced that KPMG had resigned, effective April 29, 2011. In this  
3 Form 8-K, ShengdaTech provided additional details concerning the “serious  
4 discrepancies and unexplained issues” KPMG had identified in its audits of the  
5 Company’s 2010 Financial Statement, noting that these “concerns included serious  
6 discrepancies and unexplained issues relating to, among others: (i) the Company’s  
7 bank balances; (ii) transactions with major suppliers; (iii) VAT invoices and  
8 payments; (iv) sales and payments for sales by third parties; (v) sales to the  
9 Company’s second largest customer; (vi) discrepancies between KPMG HK’s  
10 direct calls to customers and confirmations returned by mail; and (vii) concerns  
11 raised by directly confirming customer sales and accounts receivables.”

12           52. In addition, the May 5, 2011 Form 8-K made the stunning revelation  
13 that the Company’s previously-issued financial statements for the 2008 and 2009  
14 fiscal years should no longer be relied upon:

15           *On April 29, 2011, we were also informed by KPMG, our*  
16           *former independent accounting firm, that disclosures*  
17           *should be made and action should be taken to prevent*  
18           *future reliance on their previously issued audit reports*  
19           *related to the consolidated balance sheets of*  
20           *ShengdaTech, Inc. and its subsidiaries as of December*  
21           *31, 2008 and 2009, and the related consolidated*  
22           *statements of income, shareholders’ equity and*  
              *comprehensive income, and cash flows for the years then*  
              *ended and the effectiveness of internal control over*  
              *financial reporting as of December 31, 2008 and 2009.*

23           KPMG stated that the manner of management’s conduct  
24 during the investigation by a special committee of the  
25 Company’s Board of Directors *raised doubts about*  
26 *management’s representations provided to KPMG in*  
27 *connection with KPMG’s 2008 and 2009 audits of the*  
28 *consolidated financial statements and the effectiveness of*  
*our internal control over financial reporting of the*  
*Company. The Chairman of our Audit Committee*  
*discussed the foregoing issues with KPMG, and the*



1 Company will authorize KPMG to respond fully to  
2 inquiries of the successor accountant, when hired,  
3 concerning the foregoing.

4 (emphasis added).

5 53. On June 8, 2011, the NASDAQ Listing Qualifications Panel (the  
6 “Panel”) affirmed its decision to delist ShengdaTech. In support of its decision,  
7 the Panel cited, among other things, the discrepancies found by KPMG. The Panel  
8 further noted that ShengdaTech management was obstructing the Special  
9 Committee’s ability to fulfill its duties and responsibilities under Listing Rule  
10 5603(c)(3) and Section 10A(m)(2) of the Exchange Act. Trading in  
11 ShengdaTech’s common stock was suspended on June 10, 2011.

12 54. On June 9, 2011, the Company announced that it would be defaulting  
13 on its obligations to the holders of the 6.0% Notes. In a Form 8-K filed that day,  
14 ShengdaTech stated:

15 Pursuant to the terms of an Indenture, dated as of May  
16 28, 2008 (the “Indenture”), between [ShengdaTech] and  
17 The Bank of New York (the “Trustee”), holders of the  
18 [6.0% Notes] had the contractual right (the “Put Option”)  
19 to require the Company to purchase on June 1, 2011 (the  
20 “Purchase Date”) any or all of the outstanding Notes held  
21 by each such holder at a purchase price of 100% of the  
22 principal amount thereof, plus any accrued and unpaid  
23 interest up to but excluding the Purchase Date, payable in  
24 cash (the “Purchase Price”). In accordance with the  
25 terms of the Indenture and the Notes, a notice of the Put  
26 Option was sent to holders of the Notes. As of May 24,  
27 2011, the deadline for holders to exercise the Put Option,  
28 *holders of all of the Notes had exercised the Put Option*  
*in the aggregate sum of \$25,578,000. The Company did*  
*not pay the Purchase Price for the Notes on the Purchase*  
*Date. Based on the nonpayment, the aggregate principal*  
*amount of the Notes, plus any accrued and unpaid*  
*interest and any other amounts due and owing on the*  
*Notes could be declared immediately due and payable by*

1 the Trustee or by holders of 25% or more of the  
2 aggregate principal amount of the Notes.

3 (emphasis added).

4 55. On June 15, 2011, ShengdaTech became obligated to pay interest on  
5 the 6.5% Notes in the amount of approximately \$4.4 million. ShengdaTech failed  
6 to pay any portion of this interest, and defaulted on the 6.5% Notes.

7 56. On August 11, 2011, the SEC initiated a regulatory proceeding titled  
8 *In re ShengdaTech, Inc.* (LA-3397). The formal Order entered by the SEC in  
9 connection with this proceeding challenged, among other things, false statements  
10 in the Company's financial results for the fiscal years 2009 and 2010.

11 57. On August 19, 2011, ShengdaTech filed for bankruptcy protection in  
12 the United States Bankruptcy Court for the District of Nevada. ShengdaTech  
13 acknowledged in a Form 8-K filed with the SEC on August 23, 2011 that the  
14 bankruptcy filing constituted an "event of default" on the 6.0% Notes and the 6.5%  
15 Notes.

16 58. Also on August 19, 2011, the Special Committee announced that it  
17 had removed all members of ShengdaTech's management – including Chen – from  
18 their positions, effective immediately. Chen had been ShengdaTech's President  
19 and CEO at all times during Hansen's and KPMG's respective audits of the  
20 Company's 2007, 2008 and 2009 Financial Statements. Michael Kang of Alvarez  
21 & Marshal North America LLP was appointed to act as Chief Restructuring  
22 Officer ("CRO") and ShengdaTech's sole officer with responsibility to (i) manage  
23 ShengdaTech's business and operations, (ii) assist ShengdaTech in conducting its  
24 ongoing investigation, and (iii) restructure ShengdaTech's operations.

25 59. On August 22, 2011, the SEC served ShengdaTech with a subpoena  
26 for documents in connection with a fact-finding investigation by the SEC with  
27 regard to the Company.

28 60. On December 15, 2011, NASDAQ officially delisted ShengdaTech.

1 The stock had not traded on NASDAQ since its June 10, 2011 suspension.

2 61. On February 15, 2012, the SEC filed a proof of claim against  
3 ShengdaTech. In this proof of claim, the SEC indicated that its investigation into  
4 the Company was continuing and that it may file a civil action against  
5 ShengdaTech based on possible violations of the federal securities laws.

6 62. On October 12, 2012, ShengdaTech announced the findings of the  
7 Special Committee investigation in a tersely-worded press release:

8 The Special Committee's investigation, among other key  
9 findings, confirmed KPMG's initial reports concerning  
10 discrepancies and/or issues relating to the Company's  
11 financial records that were identified during the course of  
12 the audit for the year ended December 31, 2010.

13 63. The few details concerning the Special Committee's investigation that  
14 have been revealed in ShengdaTech's bankruptcy filings indicate that  
15 ShengdaTech management was engaged in a massive fraud throughout the Loss  
16 Period. The Special Committee's investigation quickly revealed serious problems  
17 – including an inability to verify matters as simple as whether ShengdaTech  
18 actually had any cash in its bank accounts – that indicate that the fraud would have  
19 been relatively easy for ShengdaTech's auditors and underwriters to uncover  
20 during the Loss Period, had they been looking. According to a filing in  
21 ShengdaTech's bankruptcy:

22 The Special Committee instructed teams of professionals  
23 from [O'Melveny] and PwC to visit financial institutions  
24 holding [ShengdaTech's] accounts in China in order to  
25 verify [the Company's] cash accounts, but managers of  
26 the PRC Companies obstructed those efforts. The  
27 Special Committee was informed that managers: stalled  
28 or otherwise attempted to derail trips to [ShengdaTech's]  
financial institutions; refused to cooperate with  
[O'Melveny] and PwC; once at the banks, attempted to  
steer the team to specific persons at the banks, rather than  
permit [O'Melveny] and PwC teams to speak with other

1 identified individuals; and when [O'Melveny] and PwC  
2 teams refused to meet with particular bank employees  
3 chosen by the managers, the managers departed and  
4 refused to assist them.

5 64. Management's complete refusal to assist in the investigation  
6 underscores the conclusion that ShengdaTech was engaged in an outright fraud.  
7 Moreover, the immediate ease with which such obstructionist tactics were  
8 deployed suggests that, had Defendants been asking questions earlier, they would  
9 have uncovered the fraud or, at the very least, they would have encountered similar  
10 obstructionism, and would have refused to issue unqualified audit opinions and/or  
11 to participate in ShengdaTech's securities offerings.

12 65. The Special Committee was also unable to verify the authenticity of  
13 certain United States certificates of deposit ("CDs") that ShengdaTech had  
14 reported as assets on its balance sheet during the Loss Period. While Chen  
15 provided the Special Committee with photocopies of the CDs as evidence that  
16 ShengdaTech had certain cash on hand, Chen was "unresponsive" to requests for  
17 further information about these CDs, and the Special Committee learned that the  
18 bank that purportedly issued the CDs was unable to verify them and, in fact, had no  
19 record of issuing them to the ShengdaTech subsidiary (Faith Bloom) that  
20 reportedly held them. The evidence uncovered to date seems to clearly indicate  
21 that ShengdaTech's management falsified evidence, in a most primitive way, to  
22 create the illusion of having materially more assets than the Company truly had.  
23 Had Defendants undertaken the simple step during the Loss Period of verifying  
24 these CDs with the banks that were reported to have issued them, they would have  
25 discovered the fraud.

26 66. The Special Committee also uncovered evidence that ShengdaTech  
27 materially overstated its sales figures during the Loss Period by, among other  
28 things, reporting fictitious transactions with customers and with entities owned by

1 Chen. According to a bankruptcy court filing by ShengdaTech in August 2011, a  
2 report prepared by the Special Committee's counsel "calls into serious question the  
3 accuracy of payments allegedly made to [ShengdaTech] by various customers or  
4 the sales allegedly made, transactions [ShengdaTech] is reported to have engaged  
5 in with related parties owned by Mr. Chen which have not been supported, and  
6 suggests that sales are vastly overstated."

7 67. Chen and other former members of ShengdaTech management  
8 repeatedly obstructed the Special Committee's investigation, preventing Plaintiffs  
9 from fully discovering the depth of ShengdaTech management's fraud. Chen  
10 refused to meet with the Board or the Special Committee, and even attempted to  
11 use his voting control over the Company to appoint a new member to the Board  
12 who, presumably, would be friendly to Chen's interests and would empower Chen  
13 with the votes needed to remove members of the Special Committee and further  
14 obstruct the investigation. These shenanigans led ShengdaTech to file an  
15 Adversary Proceeding Complaint in the bankruptcy action to enjoin Chen from  
16 interfering with the Special Committee and the CRO or taking any steps to remove  
17 any members of the Special Committee or the CRO. *See* Adversary Proceeding  
18 Complaint filed on August 20, 2011 in *In re ShengdaTech, Inc.*, Case No. BK-11-  
19 52649 (Bankr. D. Nev.).

20 68. On October 7, 2011, ShengdaTech filed a declaration by CRO Kang  
21 in which Kang reported that he had "recently visited China, with other officers of  
22 [ShengdaTech] and certain of the [Company's] professionals, in an attempt to  
23 gather more information about [certain affiliates of ShengdaTech who had not filed  
24 for bankruptcy]." During that trip, Kang visited ShengdaTech's operating  
25 subsidiaries in China and "among other things, requested financial information and  
26 asked questions regarding the value, operations and profitability of the PRC  
27 Companies." Those requests were denied, according to Kang. He stated that the  
28 "plant managers at these locations refused to provide financial information and

1 refused to answer any questions relating to the financial condition of the PRC  
2 Operating Subsidiaries” and, further, that ShengdaTech’s subsidiaries in China  
3 were “acting outside of the control of [ShengdaTech].” Finally, Kang disclosed  
4 that the Company had “limited access to its books and records, limited access to  
5 Faith Bloom’s books and records and no access to the PRC Subsidiaries’ current  
6 books and records.”

7 69. It is clear that *ShengdaTech’s financial records were falsified* and  
8 that serious issues remain unanswered regarding ShengdaTech’s financial  
9 condition and its overall business operations. Notably, in ShengdaTech’s  
10 Disclosure Statement for The Chapter 11 Plan of Reorganization filed with the  
11 bankruptcy court on May 16, 2012, the Company disclosed that Faith Bloom bank  
12 accounts that had been reported to contain \$73 million in reality contained only  
13 about \$50,000.

14 70. The falsification of ShengdaTech’s financial statements by  
15 ShengdaTech management, and the failure of Hansen, KPMG and Morgan Stanley  
16 to detect and correct the false statements, caused substantial harm to Plaintiffs HFR  
17 and DPERS and the funds and client accounts on whose behalf the other Plaintiffs  
18 purchased the Notes. Having purchased the Notes at or near par value, these  
19 investors are now left holding Notes worth only a small fraction of what was paid  
20 for them, if indeed they have any value at all. ShengdaTech’s Plan of  
21 Reorganization has been confirmed by the Bankruptcy Court, and to date the Note  
22 holders have recovered nothing on their Notes.

23 **C. The False Statements And Omissions Of Material Fact In**  
24 **ShengdaTech’s Form 10-K Filings And Offering Memoranda**

25 71. Though Plaintiffs had no way of knowing it at the time they purchased  
26 the Notes during the Loss Period, the documents upon which they relied in making  
27 those purchases – ShengdaTech’s Form 10-K filings and Offering Memoranda –  
28 contained material false statements and omitted material facts.



1           72. Among other things, the 2007, 2008 and 2009 Financial Statements  
2 contained in the Form 10-K filings and Offering Memoranda were not presented in  
3 conformity with GAAP. As a result, they violated SEC regulations.

4           73. The SEC regulates statements by companies “that can reasonably be  
5 expected to reach investors and the trading markets, whoever the intended primary  
6 audience.” SEC Release No. 33-6504, 3 Fed. Sec. L. Rep. (CCH) ¶ 23, 120, at 17,  
7 095-3, 17 C.F.R. § 241.20560 (Jan. 13, 1984). SEC Regulation S-X requires that  
8 financial statements filed with the SEC conform with GAAP. Financial statements  
9 filed with the SEC that are not prepared in conformity with GAAP are presumed to  
10 be misleading. 17 C.F.R. § 210.4-01(a)(1).

11           74. Some of the GAAP principles that were applicable to ShengdaTech  
12 during the Loss Period include:

- 13           a) that financial reporting should provide information about the  
14 economic resources of an enterprise, the claims to those  
15 resources, and the effects of transactions, events, and  
16 circumstances that change resources and claims to those  
17 resources (Financial Accounting Standards Board Statements  
18 (“FASB”) Statement of Concepts No. 1, ¶ 40);
- 19           b) that financial reporting should provide information that is  
20 useful to present and potential investors and creditors in making  
21 rational investment, credit and similar decisions (FASB  
22 Statement of Concepts No. 1, ¶ 34);
- 23           c) that financial reporting should provide information about how  
24 management of an enterprise has discharged its stewardship  
25 responsibilities to owners for the use of enterprise resources  
26 entrusted to it – to the extent that management offers securities  
27 of the enterprise to the public, it voluntarily accepts wider  
28 responsibilities for accountability to prospective investors and  
to the public in general (FASB Statement of Concepts No. 1, ¶  
50);
- d) that financial reporting should be reliable in that it represents  
what it purports to represent (FASB Statement of Concepts No.  
2, ¶¶ 58-59); and

- e) that information is complete and nothing is left out that may be necessary to insure that it validly represents underlying events and conditions (FASB Statement of Concepts No. 2, ¶¶ 79, 80).

75. ShengdaTech's 2007, 2008 and 2009 Financial Statements violated the foregoing GAAP principles and SEC regulations because, *inter alia*, they provided inaccurate information about ShengdaTech, its resources, and the claims against those resources; omitted information that was material to the investment and credit decisions of present and prospective investors and creditors; and presented information that was neither reliable nor complete.

**1. The 2007 10-K/A and the 6.0% Notes Offering Memorandum**

76. The 2007 10-K/A and the 6.0% Notes Offering Memorandum each included the Company's 2007 Financial Statements, which reported, *inter alia*, cash and cash equivalents of \$26,366,568; total assets of \$100,943,938; sale of products of \$100,654,793; and net income of \$27,030,345. These statements were false and misleading because the Company's reported results for cash and cash equivalents, total assets, sale of products, and net income were materially overstated.

77. Hansen consented to the inclusion of its March 14, 2008 audit opinion on ShengdaTech's 2007 Financial Statements in the 2007 10-K/A and the 6.0% Notes Offering Memorandum. Hansen's opinion stated, in pertinent part:

We have audited the accompanying consolidated balance sheets of ShengdaTech Inc. and subsidiaries (the Company) as of December 31, 2007 ... and the related consolidated statements of income and comprehensive income, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2007. We also have audited the Company's internal control over financial reporting as of December 31, 2007 based on criteria established in *Internal Control-Integrated*

1           *Framework* issued by the Committee of Sponsoring  
2           Organizations of the Treadway Commission (COSO)....

3           We conducted our audits in accordance with the  
4           standards of the Public Company Accounting Oversight  
5           Board (United States). Those standards require that we  
6           plan and perform the audits to obtain reasonable  
7           assurance about whether the financial statements are free  
8           of material misstatement and whether effective internal  
9           control over financial reporting was maintained in all  
10          material respects. Our audits of the financial statements  
11          included examining, on a test basis, evidence supporting  
12          the amounts and disclosures in the financial statements,  
13          assessing the accounting principles used and significant  
14          estimates made by management, and evaluating the  
15          overall financial statement presentation. Our audit of  
16          internal control over financial reporting included  
17          obtaining an understanding of internal control over  
18          financial reporting, assessing the risk that a material  
19          weakness exists, and testing and evaluating the design  
20          and operating effectiveness of internal control based on  
21          the assessed risk. Our audits also included performing  
22          such other procedures as we considered necessary in the  
23          circumstances. We believe that our audits provide a  
24          reasonable basis for our opinions.

25          A company's internal control over financial reporting is a  
26          process designed to provide reasonable assurance  
27          regarding the reliability of financial reporting and the  
28          preparation of financial statements for external purposes  
in accordance with generally accepted accounting  
principles. A company's internal control over financial  
reporting includes those policies and procedures that (1)  
pertain to the maintenance of records that, in reasonable  
detail, accurately and fairly reflect the transactions and  
dispositions of the assets of the company; (2) provide  
reasonable assurance that transactions are recorded as  
necessary to permit preparation of the financial  
statements in accordance with generally accepted  
accounting principles, and that receipts and expenditures  
of the company are being made only in accordance with  
authorizations of management and directors of the

1 company; and (3) provide reasonable assurance regarding  
2 prevention or timely detection of unauthorized  
3 acquisition, use or disposition of the company's assets  
4 that could have a material effect on the financial  
statements....

5 *In our opinion, the consolidated financial statements*  
6 *referred to above present fairly, in all material respects,*  
7 *the financial position of Shengdatech Inc. and*  
8 *subsidiaries as of December 31, 2007 ... and the results*  
9 *of their operations and their cash flows for each of the*  
10 *three years in the period ended December 31, 2007 in*  
11 *conformity with accounting principles generally*  
12 *accepted in the United States of America. Also, in our*  
13 *opinion, Shengdatech Inc. and subsidiaries maintained,*  
14 *in all material respects, effective internal control over*  
*financial reporting as of December 31, 2007, based on*  
criteria established in *Internal Control-Integrated*  
*Framework* issued by the Committee of Sponsoring  
Organizations of the Treadway Commission (COSO)....

15 (emphasis added).

16 78. Hansen's audit report was materially false and misleading because:  
17 the 2007 Financial Statements violated GAAP and did not present the Company's  
18 financial position fairly or accurately; ShengdaTech's internal controls over  
19 financial reporting were severely deficient; and, as discussed in more detail below,  
20 Hansen did not conduct its audits in accordance with the standards of GAAS and  
21 the Public Company Accounting Oversight Board.

## 22 **2. The 2008 10-K**

23 79. On April 1, 2009, ShengdaTech filed the 2008 10-K with the SEC.  
24 The 2008 10-K included the Company's 2007 and 2008 Financial Statements,  
25 which reported, *inter alia*, cash of \$26,366,568 and \$114,287,073, respectively;  
26 total assets of \$100,943,938 and \$243,908,940, respectively; net sales of  
27 \$100,654,793 and \$149,427,139, respectively; and net income of \$27,030,345 and  
28 \$40,035,451, respectively. These statements were false and misleading because

1 the Company's reported results for cash and cash equivalents, total assets, sale of  
2 products, and net income were materially overstated.

3 80. KPMG HK consented to the inclusion of its audit opinion on the  
4 Company's 2008 Financial Statements in the 2008 10-K. Despite having identified  
5 material weaknesses in ShengdaTech's internal controls over financial reporting,  
6 KPMG HK issued a clean opinion on the Company's 2008 Financial Statements,  
7 representing that they fairly presented the Company's financial position in  
8 accordance with GAAP:

9 We have audited the accompanying consolidated balance  
10 sheet of ShengdaTech, Inc. and subsidiaries (the  
11 "Company") as of December 31, 2008, and the related  
12 consolidated statements of income, shareholders' equity  
13 and comprehensive income, and cash flows for the year  
14 then ended....

15 We conducted our audit in accordance with the standards  
16 of the Public Company Accounting Oversight Board  
17 (United States). Those standards require that we plan and  
18 perform the audit to obtain reasonable assurance about  
19 whether the financial statements are free of material  
20 misstatement. An audit includes examining, on a test  
21 basis, evidence supporting the amounts and disclosures in  
22 the financial statements. An audit also includes assessing  
23 the accounting principles used and significant estimates  
24 made by management, as well as evaluating the overall  
25 financial statement presentation. We believe that our  
26 audit provides a reasonable basis for our opinion.

27 ***In our opinion, the consolidated financial statements***  
28 ***referred to above present fairly, in all material respects,***  
***the financial position of ShengdaTech, Inc. and***  
***subsidiaries as of December 31, 2008, and the results of***  
***their operations and their cash flows for the year then***  
***ended, in conformity with U.S. generally accepted***  
***accounting principles.***

29 We also have audited, in accordance with the standards  
30 of the Public Company Accounting Oversight Board

(United States), the Company's internal control over financial reporting as of December 31, 2008, based on criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated March 31, 2009 expressed an adverse opinion on the effectiveness of the Company's internal control over financial reporting.

(emphasis added).

81. Hansen consented to the inclusion of its audit opinion concerning the Company's 2007 Financial Statements in the 2008 10-K. Hansen also issued a clean audit opinion, stating that the Company's 2007 Financial Statements presented fairly, in all material respects, ShengdaTech's financial position in accordance with GAAP:

We have audited the accompanying consolidated balance sheet of Shengdatech Inc. and subsidiaries (the Company) as of December 31, 2007, and the related consolidated statements of income, shareholders' equity and comprehensive income and cash flows for each of the two years in the period ended December 31, 2007....

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States).... We believe that our audits provide a reasonable basis for our opinions.

***In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Shengdatech Inc. and subsidiaries as of December 31, 2007, and the results of their operations and their cash flows for each of the two years in the period ended December 31, 2007 in conformity with accounting principles generally accepted in the United States of America.***

(emphasis added).



1           82. The foregoing statements were materially false and misleading  
2 because: the 2007 and 2008 Financial Statements violated GAAP and did not  
3 present the Company's financial position fairly or accurately; and Hansen and  
4 KPMG HK did not conduct their audits in accordance with the standards of GAAS  
5 and the Public Company Accounting Oversight Board. KPMG has admitted that  
6 KPMG HK's audit report on the Company's 2008 Financial Statements should no  
7 longer be relied upon.

8                   **3. The 2009 10-K and 2009 10-K/A**

9           83. On March 15, 2010, ShengdaTech filed its 2009 10-K with the SEC.  
10 The 2009 10-K included the Company's 2008 and 2009 Financial Statements,  
11 which reported, *inter alia*, cash of \$114,287,073<sup>3</sup> and \$115,978,763, respectively;  
12 total assets of \$243,806,829 and \$271,054,359, respectively; net sales of  
13 \$82,419,689 and \$102,121,804, respectively; and net income of \$36,028,302 and  
14 \$23,104,607, respectively. Subsequently, on September 15, 2010, ShengdaTech  
15 filed its 2009 10-K/A with the SEC, reporting the same financial results as the  
16 2009 10-K. The foregoing statements were false and misleading because the  
17 Company's reported results for cash and cash equivalents, total assets, sale of  
18 products, and net income were materially overstated in both the 2009 10-K and the  
19 2009 10-K/A.

20           84. KPMG HK consented to the inclusion of its audit opinion on the  
21 Company's 2008 and 2009 Financial Statements in the 2009 10-K and 2009 10-  
22 K/A. KPMG HK issued a clean opinion on those financial statements, stating that  
23 they fairly presented the Company's financial position in accordance with GAAP:

24                   We have audited the accompanying consolidated balance  
25                   sheets of ShengdaTech, Inc. and subsidiaries as of  
26                   December 31, 2009 and 2008, and the related

27 <sup>3</sup> The 2009 10-K adjusted the previously-reported 2008 Financial Statements to  
28 reflect the Company's adoption of FASB ASC Subtopic 470-20, *Debt With  
Conversion and Other Options*, which specifies the accounting for convertible  
debt instruments that may be settled in cash upon conversion.

1 consolidated statements of income, shareholders' equity  
2 and comprehensive income, and cash flows for the years  
3 then ended....

4 We conducted our audits in accordance with the  
5 standards of the Public Company Accounting Oversight  
6 Board (United States).... We believe that our audits  
7 provide a reasonable basis for our opinion.

8 ***In our opinion, the consolidated financial statements***  
9 ***referred to above present fairly, in all material respects,***  
10 ***the financial position of ShengdaTech, Inc. and***  
11 ***subsidiaries as of December 31, 2009 and 2008, and the***  
12 ***results of their operations and their cash flows for the***  
13 ***years then ended, in conformity with U.S. generally***  
14 ***accepted accounting principles ....***

15 (emphasis added).

16 85. KPMG HK also consented to the inclusion of its opinion on the  
17 adequacy of the Company's internal controls as of December 31, 2009 in the 2009  
18 10-K and 2009 10-K/A. KPMG HK concluded that the Company maintained  
19 adequate internal controls over financial reporting:

20 We have audited ShengdaTech, Inc.'s internal control  
21 over financial reporting as of December 31, 2009, based  
22 on criteria established in Internal Control—Integrated  
23 Framework issued by the Committee of Sponsoring  
24 Organizations of the Treadway Commission (COSO)....

25 We conducted our audit in accordance with the standards  
26 of the Public Company Accounting Oversight Board  
27 (United States).... We believe that our audit provides a  
28 reasonable basis for our opinion....

29 ***In our opinion, ShengdaTech, Inc. maintained, in all***  
30 ***material respects, effective internal control over***  
31 ***financial reporting as of December 31, 2009, based on***  
32 ***criteria established in Internal Control—Integrated***  
33 ***Framework issued by COSO....***

34 (emphasis added).

1           86. Hansen consented to the inclusion of its audit opinion on the  
2 Company's 2007 Financial Statements in the 2009 10-K and 2009 10-K/A.  
3 Hansen also issued a clean audit opinion, finding that the Company's 2007  
4 Financial Statements presented fairly, in all material respects, ShengdaTech's  
5 financial position in accordance with GAAP:

6                   We have audited the accompanying consolidated  
7 statements of income, shareholders' equity and  
8 comprehensive income, and cash flows of ShengdaTech,  
9 Inc. and subsidiaries (the Company) for the year ended  
10 December 31, 2007....

11                   We conducted our audit in accordance with the standards  
12 of the Public Company Accounting Oversight Board  
13 (United States).... We believe that our audit provides a  
14 reasonable basis for our opinion.

15                   ***In our opinion, the consolidated financial statements***  
16 ***referred to above present fairly, in all material respects,***  
17 ***the results of operations of ShengdaTech, Inc. and***  
18 ***subsidiaries and their cash flows for the year ended***  
19 ***December 31, 2007, in conformity with U.S. generally***  
20 ***accepted accounting principles.***

21 (emphasis added).

22           87. The foregoing statements were materially false and misleading  
23 because: the 2007, 2008 and 2009 Financial Statements violated GAAP and did  
24 not present the Company's financial position fairly or accurately; ShengdaTech's  
25 internal controls over financial reporting were severely deficient; and Hansen and  
26 KPMG HK did not conduct their audits in accordance with the standards of GAAS  
27 and the Public Company Accounting Oversight Board. KPMG has admitted that  
28 KPMG HK's audit reports on the Company's 2008 and 2009 Financial Statements  
should no longer be relied upon and that it has reason to doubt the efficacy of the  
Company's internal controls over financial reporting during those years.

#### 4. The 6.5% Notes Offering Memorandum

88. The 6.5% Notes Offering Memorandum included the Company's 2007, 2008 and 2009 Financial Statements, which reported, *inter alia*, cash of \$26,366,568, \$114,287,073 and \$115,978,763, respectively; total assets of \$100,943,938, \$243,806,829 and \$271,054,359, respectively; net sales of \$46,721,673, \$82,419,689 and \$102,121,804, respectively; and net income of \$27,030,345, \$36,028,302 and \$23,104,607, respectively. These statements were false and misleading because the Company's reported results for cash and cash equivalents, total assets, sale of products, and net income were materially overstated.

89. In addition, the 6.5% Notes Offering Memorandum contained unaudited financial results that were similarly false and misleading. Specifically, the 6.5% Notes Offering Memorandum reported unaudited cash of \$120,649,206 and \$115,978,763 as of September 30, 2010 and December 31, 2009, respectively; unaudited total assets of \$295,426,018 and \$271,054,359 as of September 30, 2010 and December 31, 2009, respectively; unaudited net sales of \$34,417,385 and \$25,376,060 for the three months ended September 30, 2010 and September 30, 2009, respectively; unaudited net sales of \$97,881,755 and \$72,066,915 for the nine months ended September 30, 2010 and September 30, 2009, respectively; unaudited net income of \$6,988,578 and \$4,630,411 for the three months ended September 30, 2010 and September 30, 2009, respectively; and unaudited net income of \$20,648,597 and \$16,441,216 for the nine months ended September 30, 2010 and September 30, 2009, respectively (together, the "6.5% Notes Offering Memorandum Unaudited Financial Statements"). The 6.5% Notes Offering Memorandum Unaudited Financial Statements were false and misleading because the Company's reported results for cash, total assets, sale of products, and net income were materially overstated.

90. Hansen consented to the inclusion of its March 14, 2008 audit opinion

1 on the Company's 2007 Financial Statements in the 6.5% Notes Offering  
2 Memorandum.

3 91. KPMG HK consented to the inclusion in the 6.5% Notes Offering  
4 Memorandum of its audit opinion on ShengdaTech's 2008 and 2009 Financial  
5 Statements and its opinion on the adequacy of the Company's internal controls as  
6 of December 31, 2009, which stated in pertinent part:

7 We have audited the accompanying consolidated balance  
8 sheets of ShengdaTech, Inc. and subsidiaries as of  
9 December 31, 2009 and 2008, and the related  
10 consolidated statements of income, shareholders' equity  
11 and comprehensive income, and cash flows for the years  
12 then ended. These consolidated financial statements are  
13 the responsibility of the Company's management. Our  
14 responsibility is to express an opinion on these  
15 consolidated financial statements based on our audits.

16 We conducted our audits in accordance with the  
17 standards of the Public Company Accounting Oversight  
18 Board (United States). Those standards require that we  
19 plan and perform the audit to obtain reasonable assurance  
20 about whether the financial statements are free of  
21 material misstatement. An audit includes examining, on a  
22 test basis, evidence supporting the amounts and  
23 disclosures in the financial statements. An audit also  
24 includes assessing the accounting principles used and  
25 significant estimates made by management, as well as  
26 evaluating the overall financial statement presentation.  
27 We believe that our audits provide a reasonable basis for  
28 our opinion.

*In our opinion, the consolidated financial statements  
referred to above present fairly, in all material respects,  
the financial position of ShengdaTech, Inc. and  
subsidiaries as of December 31, 2009 and 2008, and the  
results of their operations and their cash flows for the  
years then ended, in conformity with U.S. generally  
accepted accounting principles....*

1 We also have audited, in accordance with the standards  
2 of the Public Company Accounting Oversight Board  
3 (United States), ShengdaTech Inc.'s internal control over  
4 financial reporting as of December 31, 2009, based on  
5 criteria established in *Internal Control — Integrated*  
6 *Framework* issued by the Committee of Sponsoring  
7 Organizations of the Treadway Commission and *our*  
8 *report dated March 15, 2010 expressed an unqualified*  
9 *opinion on the effectiveness of the Company's internal*  
10 *control over financial reporting.*

11 (emphasis added).

12 92. The foregoing statements were materially false and misleading  
13 because: the 2007, 2008 and 2009 Financial Statements violated GAAP and did  
14 not present the Company's financial position fairly or accurately; ShengdaTech's  
15 internal controls over financial reporting were severely deficient; and Hansen and  
16 KPMG HK did not conduct their audits in accordance with the standards of GAAS  
17 and the Public Company Accounting Oversight Board. KPMG has admitted that  
18 KPMG HK's audit reports on the Company's 2008 and 2009 Financial Statements  
19 should no longer be relied upon and that it has reason to doubt the efficacy of the  
20 Company's internal controls over financial reporting during those years.

#### 21 **D. Defendants' Culpability**

22 93. In recent months, many China-based companies that have accessed  
23 the United States capital markets through "reverse mergers" similar to the  
24 ShengdaTech/Zeolite merger have come under scrutiny by the SEC, the securities  
25 exchanges on which they are listed, and the investing public because of accounting  
26 issues and fraudulent representations concerning the companies' financial  
27 performance and liquidity. The "reverse merger" process allowed these companies  
28 to sell their shares publicly without undergoing the due diligence typically  
performed by underwriters in advance of an initial public stock offering and  
without significant vetting by investors. Because of this, the role of the outside



auditor assumed special importance, as the audit opinion was the primary safeguard against financial fraud at these companies. The imprimatur of legitimacy that was placed on these companies' debt securities by virtue of the involvement of prominent investment banks as the underwriters of these offerings was similarly critical in convincing investors to entrust their capital to these companies. What investors did not know at that time, but have subsequently come to realize, is that these outward marks of legitimacy frequently provided false comfort. All too often, these companies' auditors failed to follow the appropriate procedures and precautions when conducting their audits of these companies, and issued unqualified or "clean" audit opinions notwithstanding the existence of serious internal control deficiencies and non-compliance with GAAP, and the prestigious investment banks that underwrote the debt securities offered by these companies failed to conduct reasonable investigations into the statements contained in the offering materials for these securities, most notably the unaudited financial information included in such offering materials.

94. In June 2011 – after the 6.0% and 6.5% Notes Offerings and after Plaintiffs' purchases of the Notes – the SEC issued a warning about investing in companies that access the United States capital markets via reverse mergers, citing "systemic concerns" with the quality of the auditing of Chinese firms' financial reporting.

95. In November 2011, the SEC approved tougher new exchange rules for companies that wished to enter the United States markets through reverse mergers. The new rules prohibit a reverse-merger company from listing until the company has been in the United States over-the-counter market or another regulated U.S. or foreign exchange for at least a year. The SEC further required that these companies file all required reports, including audited financial statements, with the SEC and that the companies maintain a minimum share price for 30 of 60 days immediately prior to listing.

1           96. In 2011, the SEC suspended trading in more than a dozen reverse-  
2 merger companies – at least six of which were based in China – due to lack of  
3 current, accurate information about the companies.

4           97. ShengdaTech is a prime example of a reverse-merger company whose  
5 auditors and underwriters, unbeknownst to the purchasers of its securities, failed to  
6 fulfill their duties of ensuring that truthful and accurate information was presented  
7 to the investing public.

8                   **1. The Auditor Defendants Conducted Their Audits Negligently,**  
9                   **Ignoring Warning Signs Of Fraud And Failing To Comply**  
10                   **With Generally Accepted Auditing Standards**

11           98. The federal securities laws require public companies to have annual  
12 audits conducted by outside audit firms. The reason for this requirement is to  
13 provide an independent “check” on the conduct of company management, and to  
14 provide investors with a level of comfort that a company’s financial condition and  
15 results are not being misrepresented by management. In order to provide that  
16 comfort, audits are required to be conducted in accordance with the standards of  
17 the Public Company Accounting Oversight Board (“PCAOB”).

18           99. When it became a public company in 2006, ShengdaTech retained  
19 Hansen as its auditor. Hansen issued an audit report for ShengdaTech’s 2007  
20 Financial Statements, and continued to serve as ShengdaTech’s auditor during the  
21 2008 fiscal year and, in this capacity, reviewed the Company’s interim  
22 consolidated financial statements for the quarters ended March 31, June 30, and  
23 September 30, 2008. On November 11, 2008, ShengdaTech announced that it had  
24 dismissed Hansen as its auditor and replaced Hansen with KPMG.

25           100. KPMG HK audited, and issued audit reports concerning,  
26 ShengdaTech’s 2008 and 2009 Financial Statements. KPMG USA supervised  
27 KPMG HK’s audit, since KPMG HK would be preparing an audit report  
28 concerning ShengdaTech’s compliance with United States GAAP, and

1 representing that the audit had been conducted in accordance with United States  
2 PCAOB standards.

3 101. As the outside auditors of the Company and its subsidiaries, Hansen  
4 and KPMG HK assisted in the preparation of ShengdaTech's financial statements,  
5 and audited the annual financial statements and the text that accompanied them in  
6 the Company's Form 10-K filings in each of the respective years that Hansen and  
7 KPMG HK served as auditors. Hansen and KPMG HK were also responsible for,  
8 among other things, examining ShengdaTech's system of internal controls to  
9 identify and report any material weaknesses or reportable conditions that might  
10 impact the accuracy or reliability of their financial statements. In connection with  
11 their audits, Hansen and KPMG HK had full access to the Company's books and  
12 records.

13 102. Hansen and KPMG HK were fully aware at all relevant times that  
14 their audit reports would be reviewed and relied upon by investors and potential  
15 investors in ShengdaTech. KPMG USA was similarly aware, in reviewing and  
16 approving KPMG HK's audits and audit opinions, that these audit opinions would  
17 reach and be relied upon by investors and potential investors in ShengdaTech.  
18 Indeed, Hansen and KPMG HK expressly consented to the inclusion of their audit  
19 reports for each of the relevant years in ShengdaTech's 6.0% Notes Offering  
20 Memorandum and 6.5% Notes Offering Memorandum, knowing that those  
21 documents would form the basis for investors' decisions about whether to purchase  
22 the Notes, and KPMG USA retained ultimate authority to "sign off" on the  
23 inclusion of HPMG HK's audit reports and opinions in the 6.0% Notes Offering  
24 Memorandum and the 6.5% Notes Offering Memorandum. Under those  
25 circumstances, Hansen, KPMG HK, and KPMG USA assumed a special duty to  
26 Plaintiffs and others who purchased the Notes in the Offerings, to issue their audit  
27 reports in a careful and non-negligent fashion in compliance with applicable  
28 auditing standards.

1           103. The PCAOB standards required ShengdaTech's auditors to perform  
2 their audit services according to United States GAAS, which included Statements  
3 on Auditing Standards ("SAS") issued by the American Institute of Certified  
4 Public Accountants ("AICPA"), and to issue unqualified opinions only if the  
5 Company's financial statements were fairly presented in accordance with GAAP.

6           104. GAAS requires that an auditor exercise due professional care in  
7 performing an audit and in preparing the audit report. Hansen and KPMG HK (as  
8 supervised by KPMG USA) failed to exercise due professional care, thus violating  
9 GAAS, in the performance of their audits of ShengdaTech's 2007, 2008 and 2009  
10 Financial Statements.

11           105. As purchasers of ShengdaTech Notes, Plaintiffs were particularly  
12 interested in knowing how much cash ShengdaTech had on hand. Understanding  
13 ShengdaTech's cash position was critical to Plaintiffs' ability to make a competent  
14 assessment of the likelihood that the Company would be able to make the  
15 substantial principal and interest payments required under the Notes. The 6.0%  
16 Notes Offering Memorandum noted as a "Risk Factor" the following:

17                   ***We may be unable to raise the funds to pay interest on***  
18                   ***the note, to purchase the notes on the purchase dates,***  
19                   ***upon a fundamental change or at maturity.*** The notes  
20 initially bear interest semi-annually at a rate of 6.0%, and  
21 we in certain circumstances are obligated to pay  
22 additional interest. On June 1, 2011 and June 1, 2013,  
23 holders may require us to purchase, for cash, all or a  
24 portion of their notes, at 100% of their principal amount,  
25 plus any accrued and unpaid interest to, but excluding,  
26 that date. . . . We are obligated to pay the principal  
27 amount of the notes outstanding at the maturity date. We  
28 may not have sufficient funds for any required  
repurchase of the notes or required payment of principal  
return or interest, and we may have to refinance our  
credit facilities in order to make payments under the  
notes.

1 The 6.5% Notes Offering Memorandum contained a substantially similar warning,  
2 as well as a warning that the Company may have insufficient funds for any  
3 required repurchase of the 6.0% Notes, which were senior to the 6.5% Notes.

4 106. In light of the critical importance of understanding ShengdaTech's  
5 cash position in deciding to invest in the Notes, Plaintiffs relied heavily on the  
6 Auditor Defendants, because a competently designed audit should enable an  
7 auditor – at a minimum – to verify the existence of a company's reported assets.

8 107. The Auditor Defendants were required to verify that ShengdaTech's  
9 reported assets actually existed. GAAS Standard of Fieldwork No. 3 requires an  
10 auditor to obtain "[s]ufficient competent evidential matter . . . through inspection,  
11 observation, inquiries and confirmations to afford a reasonable basis for forming  
12 an opinion regarding the financial statements under audit." This evidential matter  
13 is central to a proper audit and serves as the foundation for the auditor's opinion  
14 report. AU § 326, Evidential Matter.

15 108. Here, it is clear that the Auditor Defendants did not take the  
16 rudimentary step of verifying that ShengdaTech's reported assets actually existed  
17 during 2007-2009. When KPMG finally did take that step during its audit of the  
18 2010 Financial Statements – at the audit committee's request – it encountered  
19 obstructionist tactics by management, which ultimately led it to report potential  
20 problems to the audit committee. When the Special Committee then commenced  
21 an investigation, it too was unable to confirm the balances in the Company's bank  
22 accounts, and eventually learned that Faith Bloom bank accounts that reportedly  
23 held tens of millions of dollars in reality held only \$50,000. Had the Auditor  
24 Defendants taken the basic step of trying to confirm these bank balances and CDs  
25 earlier, they would have discovered the fraud – or at least uncovered sufficient  
26 concerns that they would have declined to issue unqualified audit opinions, thus  
27 preventing (or stopping) the fraud.

28 109. Similarly, when the Special Committee contacted the bank that had

1 reportedly issued CDs to Faith Bloom, it quickly discovered that the bank had no  
2 record of those CDs being issued. Had the Auditor Defendants sent confirmations  
3 to the bank, they, too, would have been unable to verify the existence of those  
4 CDs. Given the GAAS requirement that each audit be planned and performed with  
5 an attitude of professional skepticism, including a questioning mind and a critical  
6 assessment of audit evidence (AU §§ 230.07-08), had such obvious falsifications  
7 been discovered – as they would have if even the most rudimentary audit steps  
8 were taken – they would have sounded loud alarms to the Auditor Defendants, and  
9 the Auditor Defendants would not have issued unqualified audit reports. Absent  
10 unqualified audit reports, ShengdaTech could not have issued the Notes.

11 110. The Auditor Defendants also failed to send confirmations to  
12 ShengdaTech's customers to confirm its sales transactions. This is a standard  
13 auditing practice that is required by GAAS, but it is clear that the Auditor  
14 Defendants did not follow it, or did so negligently, given that Special Committee's  
15 counsel issued a report that "calls into serious question the accuracy of payments  
16 allegedly made to [ShengdaTech] by various customers or the sales allegedly  
17 made, transactions [ShengdaTech] is reported to have engaged in with related  
18 parties owned by Mr. Chen which have not been supported, and suggests that sales  
19 are vastly overstated."

20 111. The Auditor Defendants' failure to take the basic step of confirming  
21 ShengdaTech's assets and sales is particularly egregious here. The Auditor  
22 Defendants knew that ShengdaTech was a Chinese company formed through a  
23 reverse-merger transaction. Given the inherent lack of regulation and risk involved  
24 in such transactions, the Auditor Defendants should have been on heightened alert  
25 to the possibility of fraud. Their failure to perform basic auditing procedures like  
26 confirming bank balances and sales transactions (including sales to related parties)  
27 makes clear that they were not.

28 112. KPMG HK's failure to perform basic auditing procedures was not



1 limited to its failure to confirm balances and transactions. Because they were  
2 based in China, ShengdaTech's five operating subsidiaries (whose results were  
3 consolidated into the financial results ShengdaTech reported to the SEC) were  
4 required to report their financial results to the Chinese Administration of Industry  
5 and Commerce (the "AIC"). Because these subsidiaries were owned by a foreign  
6 company (*i.e.*, ShengdaTech), their AIC submissions were required to be audited.  
7 These AIC filings also were required to be signed by a legal representative  
8 attesting that "the content of the submitted company's annual inspection report is  
9 true." A competent auditor would have obtained and reviewed ShengdaTech's  
10 AIC filings as a crosscheck of what ShengdaTech was reporting to the SEC.  
11 KPMG HK either failed to obtain ShengdaTech's AIC filings at all or, if it did  
12 obtain them, conducted a grossly deficient review of these filings.

13 113. The results ShengdaTech reported to the AIC so materially diverged  
14 from what was reported to the SEC as to constitute the proverbial "two sets of  
15 books." These discrepancies were sufficiently large that they cannot be "explained  
16 away" as the result of differences between reporting standards between the AIC  
17 and the SEC. Had KPMG HK reviewed these AIC filings, it would have readily  
18 noted these material discrepancies.

19 114. In addition, while the 6.5% Notes Offering Memorandum stated that  
20 Zibo Haize – one of ShengdaTech's five operating subsidiaries – produced 13,350  
21 metric tons of NPCC in 2009, Zibo Haize's AIC filings reported that Zibo Haize  
22 did not begin operations until June 2010. Had KPMG HK reviewed these AIC  
23 filings, it would have realized that the 6.5% Notes Offering Memorandum  
24 contained false statements.

25 115. The fact that ShengdaTech's five operating subsidiaries were all  
26 located in China, in and of itself, posed a heightened danger of fraud. AU  
27 316.85A.2 provides that auditors should consider fraud risk where "[s]ignificant  
28 operations [are] located or conducted across international borders in jurisdictions

1 where differing business environments and cultures exist.” The Auditor  
2 Defendants failed to heed this warning, with KPMG HK having failed to take the  
3 most basic step of reviewing the operating subsidiaries’ AIC filings.

4 116. The Special Committee’s investigation also revealed that the  
5 Company had engaged in a number of transactions with entities owned by Chen.  
6 Related party transactions warrant particular attention during an audit, as they pose  
7 a particular danger of fraud. Under AU 334, KPMG HK was required to perform  
8 special procedures with respect to related party transactions to ensure that they  
9 were properly accounted for so as to reflect their economic substance.  
10 Specifically, AU 334 required KPMG HK, among other things, to:

- 11 • Obtain an understanding of the business purpose of the related party  
12 transactions;
- 13 • Examine invoices, executed copies of agreements, contracts, and other  
14 pertinent documents;
- 15 • Determine whether the transaction has been approved by the board of  
16 directors or other appropriate officials;
- 17 • Test for reasonableness the compilation of amounts to be disclosed, or  
18 considered for disclosure, in the financial statements; and
- 19 • Inspect or confirm and obtain satisfaction concerning the  
20 transferability and value of collateral.

21 117. KPMG HK failed to perform these procedures, allowing ShengdaTech  
22 to engage in undisclosed transactions with entities owned by Chen and to vastly  
23 overstate sales to those entities.

24 118. From the outset of its engagement, KPMG HK was alerted to  
25 problems with the Company’s financial reporting. Within a few months after it  
26 was retained to replace Hansen, KPMG HK reported that it had found material  
27 weaknesses in the Company’s internal controls over financial reporting.  
28 Specifically, KPMG HK’s audit report on the Company’s 2008 Financial

1 Statements noted:

2 We also have audited, in accordance with the standards  
3 of the Public Company Accounting Oversight Board  
4 (United States), the Company's internal control over  
5 financial reporting as of December 31, 2008, based on  
6 criteria established in Internal Control — Integrated  
7 Framework issued by the Committee of Sponsoring  
8 Organizations of the Treadway Commission (COSO),  
and *our report dated March 31, 2009 expressed an  
adverse opinion on the effectiveness of the Company's  
internal control over financial reporting.*

9 (emphasis added). KPMG HK's report on its audit of ShengdaTech's internal  
10 controls for the year 2008 stated:

11 A material weakness is a deficiency, or a combination of  
12 deficiencies, in internal control over financial reporting,  
13 such that there is a ***reasonable possibility that a material***  
14 ***misstatement of the company's annual or interim***  
15 ***financial statements will not be prevented or detected on***  
16 ***a timely basis. Material weaknesses have been***  
17 ***identified and included in management's assessment***  
18 ***related to the lack of adequate policies, procedures and***  
***personnel to address the accounting for and disclosures***  
***of non-routine transactions and the Company's internal***  
***control over the accounting for income taxes.***

19 We also have audited, in accordance with the standards  
20 of the Public Company Accounting Oversight Board  
21 (United States), the consolidated balance sheet of  
22 ShengdaTech, Inc. and subsidiaries as of December 31,  
23 2008, and the related consolidated statements of income,  
24 shareholders' equity and comprehensive income, and  
25 cash flows for the year then ended. These material  
26 weaknesses were considered in determining the nature,  
27 timing, and extent of audit tests applied in our audit of  
28 the 2008 consolidated financial statements, and this  
report does not affect our report dated March 31, 2009,  
which expressed an unqualified opinion on those  
consolidated financial statements.

1           ***In our opinion, because of the effect of the***  
2           ***aforementioned material weaknesses on the***  
3           ***achievement of the objectives of the control criteria,***  
4           ***ShengdaTech, Inc. and subsidiaries have not***  
5           ***maintained effective internal control over financial***  
6           ***reporting as of December 31, 2008,*** based on criteria  
7           established in Internal Control—Integrated Framework  
8           issued by the Committee of Sponsoring Organizations of  
9           the Treadway Commission (COSO).

10           (emphasis added). KPMG USA, which reviewed KPMG HK's audit work, was  
11           similarly aware of these internal control deficiencies.

12           119. The fact that “material weaknesses” existed and were uncovered by a  
13           new auditor within *months* of its retention, coupled with the fact that ShengdaTech  
14           was later revealed to have misstated such basic information such as the Company's  
15           cash balances and its sales and payments to third parties, strongly suggests that  
16           such weaknesses existed during Hansen's audit of ShengdaTech's 2007 Financial  
17           Statements and that, accordingly, Hansen did not have a reasonable basis for  
18           issuing an unqualified audit opinions on the 2007 Financial Statements or for  
19           opining that the Company had adequate internal controls. Further, the fact that  
20           KPMG HK, in its review of the Company's 2010 Financial Statements, was unable  
21           to verify something as simple as whether ShengdaTech *actually had money in the*  
22           *bank* strongly suggests that Hansen and KPMG HK were negligent, at best, in not  
23           discovering the falsity of the Company's financial statements during their 2007-  
24           2009 audits.

25           120. These known internal control deficiencies should have shaped KPMG  
26           HK's audit procedures. GAAS Standard of Fieldwork No. 2 and AU § 319 instruct  
27           auditors to obtain a sufficient understanding of a company and its internal control  
28           structure to plan an effective audit that will allow the auditor to assess the audit  
          risk associated with inadequate internal controls. “Audit risk is the risk that the  
          auditor may unknowingly fail to appropriately modify his or her opinion on

1 financial statements that are materially misstated.” AU § 312.02, Audit Risk and  
2 Materiality in Conducting an Audit. “Internal control” is defined as a process  
3 “designed to provide reasonable assurance regarding the achievement of objectives  
4 in the following categories: (a) reliability of financial reporting, (b) effectiveness  
5 and efficiency of operations, and (c) compliance with applicable laws and  
6 regulations.” AU § 319.06, Consideration of Internal Control in a Financial  
7 Statement Audit – Definition of Internal Control. For financial statement audits,  
8 internal controls serve as an integral way “to prevent or detect material  
9 misstatements in financial statement assertions.”

10 121. The fact that KPMG HK uncovered “material weaknesses” mere  
11 months into its engagement should have caused KPMG HK to seriously question  
12 the rigor that Hansen applied in auditing the Company’s 2007 Financial Statements  
13 and the basis upon which it opined that such statements complied with GAAP and  
14 that the Company had effective internal controls over its financial reporting.  
15 Instead, KPMG HK –with KPMG USA’s blessing – reassured investors that the  
16 Company’s financial statements were accurate by issuing a clean audit opinion on  
17 ShengdaTech’s 2008 and 2009 Financial Statements. For example, in its March  
18 31, 2009 audit opinion on the Company’s 2008 Financial Statements, KPMG HK  
19 stated:

20 In our opinion, the consolidated financial statements  
21 referred to above present fairly, in all material respects,  
22 the financial position of ShengdaTech, Inc. and  
23 subsidiaries as of December 31, 2008, and the results of  
24 their operations and their cash flows for the year ended,  
in conformity with U.S. generally accepted accounting  
principles.

25 Similarly, KPMG HK’s March 15, 2010 audit opinion on the Company’s 2009  
26 Financial Statements, as contained in the 6.5% Notes Offering Memorandum,  
27 stated:  
28

1 In our opinion, ShengdaTech, Inc. maintained, in all  
2 material respects, effective internal control over financial  
3 reporting as of December 31, 2009, based on criteria  
4 established in *Internal Control – Integrated Framework*  
issued by COSO.

\*\*\*

5 We have also audited, in accordance with the standards  
6 of the Public Company Accounting Oversight Board  
7 (United States), the consolidated balance sheets of  
8 ShengdaTech, Inc. and subsidiaries of December 31,  
9 2009 and 2008, and the related consolidated statements  
10 of income, shareholders' equity and comprehensive  
11 income, and cash flows for the years then ended, and our  
report dated March 15, 2010 expressed an unqualified  
opinion on those consolidated financial statements.

\*\*\*

12 In our opinion, the consolidated financial statements  
13 referred to above present fairly, in all material respects,  
14 the financial position of ShengdaTech, Inc. and  
15 subsidiaries as of December 31, 2009 and 2008, and the  
16 results of their operations and their cash flows for the  
17 years then ended, in conformity with U.S. generally  
accepted accounting principles.

18 122. Despite KPMG HK's reassurances to investors, which were  
19 sanctioned by KPMG USA, the presence of material weaknesses in ShengdaTech's  
20 internal financial controls – which KPMG HK admitted created a reasonable  
21 possibility that a material misstatement of the company's annual or interim  
22 financial statements would not be prevented or detected – should have caused  
23 KPMG HK to more starkly question the Company's management to ensure that the  
24 Company's financial statements were accurate. KPMG HK failed to do this, in  
25 violation of GAAS, and these "material weaknesses" were never adequately  
26 addressed.

27 123. The Auditor Defendants' non-compliance with GAAS left them  
28 without a reasonable basis upon which to form an opinion concerning whether the



1 Company's financial statements were fairly presented in accordance with GAAP.  
2 As discussed above, the Auditor Defendants nonetheless issued, or caused to be  
3 issued, clean audit reports representing that the Company's financial statements did  
4 comply with GAAP.

5 **2. Morgan Stanley Failed To Execute Its Duty To Conduct A**  
6 **Reasonable Investigation Into The Accuracy Of The 6.5%**  
7 **Notes Offering Memorandum**

8 124. As the underwriter whose name was displayed prominently on the  
9 cover of the 6.5% Notes Offering Memorandum, Morgan Stanley was responsible  
10 for, and is deemed to have made, the statements therein. Morgan Stanley knew  
11 that the 6.5% Notes Offering Memorandum would be disseminated to investors for  
12 the express purpose of soliciting them to purchase 6.5% Notes, and Morgan  
13 Stanley owed a duty to Plaintiffs, as prospective purchasers of the 6.5% Notes and  
14 recipients of the 6.5% Notes Offering Memorandum, to conduct a reasonable  
15 investigation into the accuracy of the statements contained in that Offering  
16 Memorandum. Morgan Stanley did not do so, and did not possess reasonable  
17 grounds for believing that the statements in the 6.5% Notes Offering Memorandum  
18 were true and not misleading. In particular, Morgan Stanley did not conduct a  
19 reasonable investigation into the accuracy of the financial information included in  
20 the 6.5% Notes Offering Memorandum, including the financial information  
21 contained in the textual portions of those documents, as well as that contained in  
22 the attached audited and unaudited financial statements.

23 125. The 6.5% Notes Offering Memorandum included the Company's  
24 2007 Financial Statements audited by Hansen, including Hansen's unqualified  
25 audit opinion thereon, and the 2008 and 2009 Financial Statements audited by  
26 KPMG, including KPMG's unqualified audit opinions thereon. The 6.5% Notes  
27 Offering Memorandum also included the 6.5% Notes Offering Memorandum  
28 Unaudited Financial Statements. Because KPMG HK had not audited any of the

1 6.5% Notes Offering Memorandum Unaudited Financial Statements, the investing  
2 public placed particular reliance upon Morgan Stanley's due diligence as  
3 underwriter for the 6.5% Notes Offering to investigate and verify the accuracy of  
4 the 6.5% Notes Offering Unaudited Financial Statements.

5 126. As set forth above, the audited and unaudited financial statements  
6 contained in the 6.5% Notes Offering Memorandum were riddled with  
7 misstatements. The 6.5% Notes Offering Unaudited Financial Statements  
8 materially overstated, *inter alia*, ShengdaTech's cash, total assets, sale of products,  
9 and net income for the period ended September 30, 2010. Had Morgan Stanley  
10 made any effort to confirm the Company's bank balances or sales transactions for  
11 that period – which it knew had not been audited by KPMG – it would have  
12 discovered the fraud and the 6.5% Notes would never have been issued.  
13 Moreover, far from being matters that only a trained auditor could detect, the  
14 misstatements in the Company's financial statements would have been readily  
15 apparent had Morgan Stanley reviewed the AIC filings of ShengdaTech's  
16 operating subsidiaries.

17 127. KPMG HK's inability during its audit of the 2010 Financial  
18 Statements to verify such basic facts as whether ShengdaTech *actually had money*  
19 *in the bank* strongly suggests that whatever investigation Morgan Stanley may  
20 have conducted into the accuracy of the audited and unaudited financial statements  
21 included in the 6.5% Notes Offering Memorandum was not reasonable and that,  
22 accordingly, Morgan Stanley had no reasonable basis to conclude that these  
23 audited and unaudited financial statements were accurate.

24 128. The fact that ShengdaTech accessed the United States capital markets  
25 via a "reverse merger" process should have placed Morgan Stanley on heightened  
26 alert to the importance of its role. Morgan Stanley, as one of Wall Street's most  
27 profitable and prestigious banks, was undoubtedly aware that potential investors  
28 would be relying on the imprimatur of legitimacy stamped on the 6.5% Notes

1 Offering by its involvement given the circumstances of the Offering.

2 **VI. LOSS CAUSATION**

3 129. As described herein, Defendants made or caused to be made a series  
4 of materially false or misleading statements about ShengdaTech's financial  
5 condition and, in the case of the Auditor Defendants, the adequacy of its financial  
6 controls. These material misstatements and omissions had the purpose and effect  
7 of creating in the market an unrealistically positive assessment of ShengdaTech  
8 and its business, prospects and operations, thus fraudulently creating a market for  
9 the Notes and causing the Notes to be overvalued and artificially inflated at all  
10 times relevant hereto. Defendants' materially false and misleading statements  
11 resulted in Plaintiffs purchasing or otherwise acquiring Notes that would never  
12 have come into the market but for the fraud or, at a minimum, would have come  
13 into the market at substantially lower prices and/or on terms far more favorable to  
14 investors. But for Defendants' misrepresentations, Plaintiffs would not have  
15 purchased the Notes at all, or would not have purchased them on the terms and at  
16 the artificially inflated prices at which they entered the market. As the truth about  
17 ShengdaTech began to be revealed, the inflation caused by these  
18 misrepresentations was eliminated from the price of the Notes and ShengdaTech  
19 defaulted on the Notes, causing damages to Plaintiffs HFR and DPERS and the  
20 funds and client accounts on whose behalf the other Plaintiffs purchased the Notes.

21 130. On March 14, 2011 – the day before ShengdaTech disclosed that  
22 KPMG had uncovered improprieties in the Company's 2010 Financial Statements  
23 – ShengdaTech's common stock closed at \$3.55. Although NASDAQ halted  
24 trading in ShengdaTech common stock on March 15, 2011, the stock traded on  
25 several days in June 2011. On June 10, 2011, ShengdaTech opened at \$0.55; by  
26 the close of trading, it was down to \$0.25. ShengdaTech continued to trade  
27 throughout the month of June at levels between \$0.23 and \$0.90 – far below its  
28 pre-disclosure trading price of \$3.55.

131. Plaintiffs purchased Notes in the offerings and in the secondary market at or near par, and in many cases above par value. The Notes prices fell precipitously in response to the revelations of the financial irregularities at ShengdaTech. After trading at or above \$96 during the two weeks ended March 11, 2011, the 6.5% Notes fell to price of approximately \$82 the following week. The price declined into the \$70 range in May 2011, and by mid-June 2011 the 6.5% Notes were trading at less than \$20.

132. ShengdaTech defaulted on both the 6.0% Notes and the 6.5% Notes. Its default on the Notes was caused, in substantial part, by the revelation that ShengdaTech's financial statements for 2007-2009, as to which Hansen and/or KPMG HK had issued clean audit opinions and which were incorporated in the Offering Memoranda for the Notes, were materially false and unreliable, and that the Company did not actually possess all of the assets reflected on its financial statements.

## **VII. TOLLING OF THE STATUTE OF LIMITATIONS**

133. On March 15, 2012, Plaintiffs entered into agreements with KPMG HK, KPMG USA, KPMG International and Hansen whereby all statutes of limitations and repose for Plaintiffs' claims against KPMG and Hansen were tolled from March 15, 2012 through the termination of the agreements. The agreements were later terminated, effective on June 6, 2012.

134. All of Plaintiffs' claims have been brought within the applicable statutes of limitations, after giving effect to tolling.

## **VIII. CLAIMS FOR RELIEF**

### **FIRST CLAIM FOR RELIEF** **Violation of Section 18 of the Exchange Act** **(Against Hansen For False Statements In The 2007 10-K/A)**

135. Plaintiffs repeat and reallege each and every allegation contained above as if fully set forth herein.

136. This claim is asserted against Hansen for violation of Section 18 of

1 the Exchange Act.

2 137. As set forth above, Hansen made or caused to be made statements that  
3 were, at the time and in light of the circumstances under which they were made,  
4 false or misleading with respect to material facts in the Company's 2007 10-K/A.

5 138. In connection with their decisions to purchase the Company's Notes,  
6 Plaintiffs read and relied upon the Company's 2007 10-K/A. Specifically,  
7 Plaintiffs read and relied on the Company's 2007 Financial Statements contained  
8 in the 2007 10-K/A. Plaintiffs also read and relied upon the unqualified audit  
9 opinion issued by Hansen in connection with those Financial Statements, in which  
10 Hansen stated that the 2007 Financial Statements fairly presented the Company's  
11 financial condition and the results of its operations in accordance with GAAP and  
12 that the Company maintained effective internal controls over financial reporting  
13 during that year.

14 139. For purposes of this Count, allegations that Plaintiff HFR read and  
15 relied upon statements in the 2007 10-K/A refer to Lazard Asset Management  
16 LLC's reading and reliance as agent on behalf of HFR, and allegations that  
17 Plaintiff DPERS read and relied upon statements in the 2007 10-K/A refer to  
18 Oaktree Capital Management, L.P.'s reading and reliance as agent on behalf of  
19 DPERS.

20 140. Plaintiffs reasonably relied on these statements not knowing that they  
21 were false or misleading.

22 141. When the truth began to emerge about the false and misleading  
23 statements in the Company's 2007 10-K/A, Plaintiffs HFR and DPERS and the  
24 funds and client accounts on whose behalf the other Plaintiffs purchased the Notes  
25 were significantly damaged by the resulting drop in the value of the Notes and the  
26 Company's default on its obligations under the Notes.

27 142. As a direct and proximate result of Defendant Hansen's wrongful  
28 conduct, Plaintiffs HFR and DPERS and the funds and client accounts on whose

1 behalf the other Plaintiffs purchased the Notes suffered damage in connection with  
2 Plaintiffs' purchases of the Notes.

3 143. By virtue of the foregoing, Defendant Hansen has violated Section 18  
4 of the Exchange Act.

5 **SECOND CLAIM FOR RELIEF**  
6 **Violation of Section 18 of the Exchange Act**  
7 **(Against Hansen and KPMG HK For False Statements In The 2008 10-K)**

8 144. Plaintiffs repeat and reallege each and every allegation contained  
9 above as if fully set forth herein.

10 145. This claim is asserted against Defendants Hansen and KPMG HK for  
11 violation of Section 18 of the Exchange Act.

12 146. As set forth above, Defendants Hansen and KPMG HK made or  
13 caused to be made statements that were, at the time and in light of the  
14 circumstances under which they were made, false or misleading with respect to  
15 material facts, in the Company's 2008 10-K.

16 147. In connection with their decisions to purchase the Company's Notes,  
17 Plaintiffs specifically read and relied upon the Company's 2008 10-K.  
18 Specifically, Plaintiffs read and relied on the Company's 2007 Financial  
19 Statements contained in the 2008 10-K, as well as the unqualified audit opinion in  
20 which Hansen stated that the 2007 Financial Statements fairly presented the  
21 Company's financial condition and the results of its operations in accordance with  
22 GAAP. Plaintiffs also specifically read and relied on the Company's 2008  
23 Financial Statements contained in the 2008 10-K, as well as the unqualified audit  
24 opinion in which KPMG HK stated that the 2008 Financial Statements fairly  
25 presented the Company's financial condition and the results of its operations in  
26 accordance with GAAP.

27 148. For purposes of this Count, allegations that Plaintiff HFR read and  
28 relied upon statements in the 2008 10-K refer to Lazard Asset Management LLC's  
reading and reliance as agent on behalf of HFR, and allegations that Plaintiff



1 DPERS read and relied upon statements in the 2008 10-K refer to Oaktree Capital  
2 Management, L.P.'s reading and reliance as agent on behalf of DPERS.

3 149. Plaintiffs reasonably relied on these statements not knowing that they  
4 were false or misleading.

5 150. When the truth began to emerge about the false and misleading  
6 statements and omissions in the Company's 2008 10-K, Plaintiffs HFR and  
7 DPERS and the funds and client accounts on whose behalf the other Plaintiffs  
8 purchased the Notes were significantly damaged by the resulting drop in the value  
9 of the Notes and the Company's default on its obligations under the Notes.

10 151. As a direct and proximate result of Defendants' wrongful conduct,  
11 Plaintiffs HFR and DPERS and the funds and client accounts on whose behalf the  
12 other Plaintiffs purchased the Notes suffered damage in connection with Plaintiffs'  
13 purchases of the Notes.

14 152. By virtue of the foregoing, Defendants have violated Section 18 of the  
15 Exchange Act.

16 **THIRD CLAIM FOR RELIEF**  
17 **Violation of Section 18 of the Exchange Act**  
18 **(Against Hansen and KPMG HK**  
**For False Statements In The 2009 10-K And 2009 10-K/A)**

19 153. Plaintiffs repeat and reallege each and every allegation contained  
20 above as if fully set forth herein.

21 154. This claim is asserted against Defendants Hansen and KPMG HK for  
22 violation of Section 18 of the Exchange Act.

23 155. As set forth above, Hansen and KPMG HK made or caused to be  
24 made statements that were, at the time and in light of the circumstances under  
25 which they were made, false or misleading with respect to material facts, in the  
26 Company's 2009 10-K and 2009 10-K/A.

27 156. In connection with their decisions to purchase the Company's Notes,  
28 Plaintiffs read and relied upon the Company's 2009 10-K and 2009 10-K/A.

1 Specifically, Plaintiffs read and relied on the Company's 2007 Financial  
2 Statements contained in the 2009 10-K and 2009 10-K/A, as well as the  
3 unqualified audit opinion in which Hansen stated that the 2007 Financial  
4 Statements fairly presented the Company's financial condition and the results of its  
5 operations in accordance with GAAP. Plaintiffs also read and relied on the  
6 Company's 2008 and 2009 Financial Statements contained in the 2009 10-K and  
7 2009 10-K/A, as well as the unqualified audit opinion in which KPMG HK stated  
8 that the 2008 and 2009 Financial Statements fairly presented the Company's  
9 financial condition and the results of its operations in accordance with GAAP, and  
10 KPMG HK's statement that the Company maintained effective internal controls  
11 over financial reporting during the fiscal year ending December 31, 2009.

12 157. For purposes of this Count, allegations that Plaintiff HFR read and  
13 relied upon statements in the 2009 10-K and 2009 10-K/A refer to Lazard Asset  
14 Management LLC's reading and reliance as agent on behalf of HFR, and  
15 allegations that Plaintiff DPERS read and relied upon statements in the 2009 10-K  
16 and 2009 10-K/A refer to Oaktree Capital Management, L.P.'s reading and  
17 reliance as agent on behalf of DPERS.

18 158. Plaintiffs reasonably relied on these statements not knowing that they  
19 were false or misleading.

20 159. When the truth began to emerge about the false and misleading  
21 statements and omissions in the Company's 2009 10-K and 2009 10-K/A,  
22 Plaintiffs HFR and DPERS and the funds and client accounts on whose behalf the  
23 other Plaintiffs purchased the Notes were significantly damaged by the resulting  
24 drop in the value of the Notes and the Company's default on its obligations under  
25 the Notes.

26 160. As a direct and proximate result of Defendants' wrongful conduct,  
27 Plaintiffs HFR and DPERS and the funds and client accounts on whose behalf the  
28 other Plaintiffs purchased the Notes suffered damages in connection with

1 Plaintiffs' purchases of the Notes.

2 161. By virtue of the foregoing, Defendants have violated Section 18 of the  
3 Exchange Act.

4 **FOURTH CLAIM FOR RELIEF**  
5 **Violation of Section 20(a) of the Exchange Act**  
6 **(Against KPMG International and KPMG USA)**

7 162. Plaintiffs repeat and reallege each of the allegations set forth above as  
8 if fully set forth herein.

9 163. This Claim is asserted against KPMG International and KPMG USA  
10 pursuant to Section 20(a) of the Exchange Act.

11 164. As alleged herein, KPMG HK violated Section 18 of the Exchange  
12 Act by making false and misleading statements in ShengdaTech's 2008 10-K, 2009  
13 10-K and 2009 10-K/A.

14 165. Plaintiffs HFR and DPERS and the funds and client accounts on  
15 whose behalf the other Plaintiffs purchased the Notes suffered damages in  
16 connection with Plaintiffs' purchases of 6.0% Notes and 6.5% Notes as a direct  
17 and proximate result of KPMG HK's violations of Section 18.

18 166. KPMG International and KPMG USA were controlling persons of  
19 KPMG HK. By virtue of the unified international structure of the auditing firm  
20 and the relationships among member firms, KPMG International had the power to  
21 influence and control, and did influence and control, directly or indirectly, the  
22 decision-making of its member firms, including KPMG HK. KPMG USA  
23 reviewed and approved KPMG HK's audit work and thus influenced and  
24 controlled, directly or indirectly, KPMG HK's conduct and decision-making with  
25 respect to its audits and audit reports concerning ShengdaTech.

26 167. KPMG International and KPMG USA are not entitled to a "good  
27 faith" defense because they cannot establish that they acted in good faith and that  
28 they did not directly or indirectly induce the acts constituting the violation of  
Section 18 by KPMG HK.

1 168. By virtue of their positions as controlling persons of KPMG HK,  
2 KPMG International and KPMG USA are each jointly and severally liable  
3 pursuant to Section 20(a) of the Exchange Act, with and to the same extent as  
4 KPMG HK, for KPMG HK's violations of Section 18 of the Exchange Act.

5 **FIFTH CLAIM FOR RELIEF**  
6 **Common Law Negligent Misrepresentation**  
7 **(On Behalf Of Plaintiff CNH Against Hansen For False**  
8 **Statements In The 6.0% Notes Offering Memorandum)**

9 169. Plaintiff CNH repeats and realleges each of the allegations set forth  
10 above as if fully set forth herein. For the purposes of this claim, CNH expressly  
11 disclaims any claim of fraud or intentional misconduct.

12 170. This claim is brought by CNH against Hansen under common law  
13 principles of negligence.

14 171. Hansen is in the business of auditing and reviewing financial  
15 statements of public companies, issuing opinion letters concerning the financial  
16 statements audited, and providing and certifying such information for the benefit of  
17 investors and others to use in their dealings with others.

18 172. Hansen expressly consented to the incorporation in the 6.0% Notes  
19 Offering Memorandum of its audit opinion on the Company's 2007 Financial  
20 Statements and its statement that the Company maintained effective internal  
21 controls over financial reporting, knowing that the 6.0% Notes Offering  
22 Memorandum would be disseminated to a limited group of potential purchasers of  
23 the 6.0% Notes for the purpose of soliciting those investors to purchase the notes.  
24 Hansen knew and intended that potential purchasers who received the 6.0% Notes  
25 Offering Memorandum would rely on its contents, including the 2007 Financial  
26 Statements and Hansen's audit report, when deciding to purchase the 6.0% Notes.

27 173. The 6.0% Notes Offering was open only to qualified institutional  
28 buyers. Plaintiff CNH is a member of the limited group of potential purchasers of  
the 6.0% Notes that received the 6.0% Notes Offering Memorandum and was

1 solicited to purchase notes in the 6.0% Notes Offering.

2 174. Hansen owed a duty of reasonable care to the investors and  
3 investment managers that received the 6.0% Notes Offering Memorandum,  
4 including Plaintiff CNH, and to the funds and accounts managed by Plaintiff CNH,  
5 because they were foreseeable and intended beneficiaries of Hansen's audit  
6 opinions.

7 175. Hansen breached this duty by failing to conduct reasonable and  
8 GAAS-compliant audits, and by falsely representing in its 2007 audit opinion that  
9 it had audited the 2007 financial statements in accordance with GAAS and  
10 PCAOB auditing standards and that those financial statements were presented  
11 fairly and in accordance with GAAP.

12 176. At the time of the misrepresentations and omissions of material fact  
13 by Hansen, Plaintiff CNH was ignorant of their falsity and believed them to be  
14 true. Plaintiff CNH relied upon the superior knowledge and expertise of Hansen,  
15 and read and justifiably relied (to the detriment of the funds on whose behalf CNH  
16 purchased the Notes) on the 2007 audited financial statements in the 6.0% Notes  
17 Offering Memorandum, on the unqualified opinion issued by Hansen in connection  
18 with those financial statements, and on Hansen's 2007 report concerning the  
19 Company's internal controls, when purchasing the 6.0% Notes in the 6.0% Notes  
20 Offering. Had Plaintiff CNH been aware of the true facts, it would not have  
21 purchased the 6.0% Notes.

22 177. Hansen's conduct constitutes the making of negligent  
23 misrepresentations under applicable state law. As a direct and proximate result of  
24 Plaintiff CNH's reliance on the negligent misrepresentations made by Hansen,  
25 Plaintiff CNH purchased 6.0% Notes in the 6.0% Notes Offering, and the funds on  
26 whose behalf Plaintiff CNH purchased the Notes suffered damages.

27 ///

28 ///

**SIXTH CLAIM FOR RELIEF**  
**Common Law Negligent Misrepresentation**  
**(On Behalf Of All Plaintiffs Against Defendants Hansen And KPMG HK**  
**For False Statements In The 6.5% Notes Offering Memorandum)**

178. Plaintiffs repeat and reallege each of the allegations set forth above as if fully set forth herein. For the purposes of this claim, Plaintiffs expressly disclaim any claim of fraud or intentional misconduct.

179. This claim is brought by Plaintiffs against Hansen and KPMG HK under common law principles of negligence.

180. Defendants are in the business of auditing and reviewing financial statements of public companies, issuing opinion letters concerning the financial statements audited, and providing and certifying such information for the benefit of investors and others to use in their dealings with others.

181. Hansen expressly consented to the incorporation of its audit opinion on the Company's 2007 Financial Statements in the 6.5% Notes Offering Memorandum, knowing that the 6.5% Notes Offering Memorandum would be disseminated to a limited group of potential purchasers of the 6.5% Notes for the purpose of soliciting those investors to purchase the notes. Hansen knew and intended that the potential purchasers who received the 6.5% Notes Offering Memorandum would rely on its contents, including the 2007 Financial Statements and Hansen's audit report, when deciding to purchase the 6.5% Notes.

182. KPMG HK expressly consented to the incorporation of its audit opinions on the Company's 2008 and 2009 Financial Statements in the 6.5% Notes Offering Memorandum, as well as KPMG HK's statement that the Company maintained effective internal controls over financial reporting during the fiscal year ending December 31, 2009, knowing that the 6.5% Notes Offering Memorandum would be disseminated to a limited group of potential purchasers of the Notes for the purpose of soliciting those investors to purchase the 6.5% Notes. KPMG HK knew and intended that the potential purchasers who received the 6.5% Notes



1 Offering Memorandum would rely on its contents, including the 2008 and 2009  
2 Financial Statements and KPMG HK's audit reports, when deciding to purchase  
3 the 6.5% Notes.

4 183. The 6.5% Notes Offering was open only to qualified institutional  
5 buyers. Plaintiffs were members of the limited group of potential purchasers of the  
6 6.5% Notes that received the 6.5% Notes Offering Memorandum and were  
7 solicited to purchase notes in the 6.5% Notes Offering.

8 184. Defendants owed a duty of reasonable care to the investors and  
9 investment managers that received the 6.5% Notes Offering Memorandum,  
10 including Plaintiffs, and to the funds and accounts managed by Plaintiffs, because  
11 they were foreseeable and intended beneficiaries of Defendants' audit opinions.

12 185. Defendants breached this duty by failing to conduct reasonable and  
13 GAAS-compliant audits, and by falsely representing in their audit opinions that  
14 they had audited the financial statements in accordance with GAAS and PCAOB  
15 auditing standards, that those financial statements were presented fairly and in  
16 accordance with GAAP, and that the Company had adequate internal controls  
17 during 2009.

18 186. At the time of the misrepresentations of material fact by Defendants,  
19 Plaintiffs were ignorant of their falsity and believed them to be true. Plaintiffs  
20 relied upon the superior knowledge and expertise of Defendants, and read and  
21 justifiably relied (to the detriment of the funds and accounts on whose behalf  
22 Plaintiffs purchased the Notes) on the audited financial statements in the 6.5%  
23 Notes Offering Memorandum, on the unqualified opinions issued by Defendants in  
24 connection with those financial statements, and on KPMG HK's report concerning  
25 the Company's internal controls, when purchasing 6.5% Notes in the 6.5% Notes  
26 Offering. Had Plaintiffs been aware of the true facts, they would not have  
27 purchased the 6.5% Notes.

28 187. For purposes of this Count, allegations that Plaintiff HFR read and

1 relied upon statements in the 6.5% Notes Offering Memorandum refer to Lazard  
2 Asset Management LLC's reading and reliance as agent on behalf of HFR, and  
3 allegations that Plaintiff DPERS read and relied upon statements in the 6.5% Notes  
4 Offering Memorandum refer to Oaktree Capital Management, L.P.'s reading and  
5 reliance as agent on behalf of DPERS.

6 188. Defendants' conduct constitutes the making of negligent  
7 misrepresentations under applicable state law. As a direct and proximate result of  
8 Plaintiffs' reliance on the negligent misrepresentations made by Defendants,  
9 Plaintiffs purchased 6.5% Notes in the 6.5% Notes Offering, and Plaintiffs HFR  
10 and DPERS and the funds and client accounts on whose behalf the other Plaintiffs  
11 purchased the Notes suffered damages.

12 **SEVENTH CLAIM FOR RELIEF**  
13 **Common Law Negligent Misrepresentation**  
14 **(Against Defendants KPMG International And KPMG USA Under The**  
15 **Doctrine Of *Respondeat Superior*, Based On KPMG HK's**  
16 **False Statements In The 6.5% Notes Offering Memorandum)**

17 189. Plaintiffs repeat and reallege each of the allegations set forth above as  
18 if fully set forth herein.

19 190. This claim is brought by Plaintiffs against Defendants KPMG  
20 International and KPMG USA based on KPMG HK's false statements contained in  
21 the 6.5% Notes Offering Memorandum under the doctrine of *respondeat superior*.

22 191. As alleged above, KPMG HK breached its duty of care to Plaintiffs  
23 and made negligent misrepresentations in its audit reports on the 2008 and 2009  
24 Financial Statements as contained in the 6.5% Notes Offering Memorandum, and  
25 Plaintiffs HFR and DEPRS and the funds and client accounts on whose behalf the  
26 other Plaintiffs purchased the Notes suffered damages as a result of Plaintiffs'  
27 reliance on those misrepresentations.

28 192. KPMG HK was an agent of Defendants KPMG International and  
KPMG USA with respect to its audits of the 2008 and 2009 Financial Statements  
and with respect to its issuance of unqualified audit opinions on the 2008 and 2009

1 Financial Statements. KPMG HK took actions in connection with its audits of the  
2 2008 and 2009 Financial Statements and its issuance of unqualified audit opinions  
3 on the 2008 and 2009 Financial Statements at the behest of KPMG International  
4 and KPMG USA, and such actions were within the scope of KPMG HK's agency.

5 193. Under principles of *respondeat superior*, KPMG International and  
6 KPMG USA are responsible for the actions and liabilities of their agent, KPMG  
7 HK, in connection with its issuance of unqualified audit opinions on the 2008 and  
8 2009 Financial Statements as contained in the 6.5% Notes Offering Memorandum.

9 **EIGHTH CLAIM FOR RELIEF**  
10 **Common Law Negligent Misrepresentation**  
11 **(Against Morgan Stanley For False Statements In**  
12 **The 6.5% Notes Offering Memorandum)**

13 194. Plaintiffs repeat and reallege each of the allegations set forth above as  
14 if fully set forth herein. For the purposes of this claim, Plaintiffs expressly  
15 disclaim any claim of fraud or intentional misconduct. Plaintiffs CNH and AQR  
16 do not join in this claim.

17 195. This claim is brought against Morgan Stanley under common law  
18 principles of negligence.

19 196. Morgan Stanley underwrote the 6.5% Notes Offering. As part of its  
20 duties as an underwriter, Morgan Stanley was required to conduct, prior to the  
21 6.5% Notes Offering, a reasonable investigation to ensure that the 6.5% Notes  
22 Offering Memorandum contained no misstatement or omission of material fact.

23 197. Morgan Stanley consented to its name being prominently displayed on  
24 the front cover of the 6.5% Notes Offering Memorandum, knowing that the 6.5%  
25 Notes Offering Memorandum would be disseminated to a limited group of  
26 potential purchasers of the 6.5% Notes for the purpose of soliciting those investors  
27 to purchase the notes. Morgan Stanley knew and intended that the potential  
28 purchasers who received the 6.5% Notes Offering Memorandum would rely on its  
contents, including the Company's audited and unaudited financial statements

1 described above, when deciding to purchase the 6.5% Notes.

2 198. The 6.5% Notes Offering was open only to qualified institutional  
3 buyers. Plaintiffs are members of the limited group of potential purchasers of the  
4 6.5% Notes that received the 6.5% Notes Offering Memorandum and were  
5 solicited to purchase notes in the 6.5% Notes Offering.

6 199. Morgan Stanley owed a duty of reasonable care to the investors and  
7 investment managers that received the 6.5% Notes Offering Memorandum,  
8 including Plaintiffs, and to the funds and accounts managed by Plaintiffs, because  
9 they were foreseeable and intended beneficiaries of the 6.5% Notes Offering  
10 Memorandum.

11 200. Morgan Stanley breached this duty by failing to conduct a reasonable  
12 investigation into the accuracy of the 6.5% Notes Offering Memorandum.

13 201. At the time of the misrepresentations and omissions of material fact  
14 by Morgan Stanley, Plaintiffs were ignorant of their falsity and believed them to be  
15 true. Plaintiffs relied upon the superior knowledge and expertise of Morgan  
16 Stanley, and read and justifiably relied (to the detriment of the funds and accounts  
17 on whose behalf Plaintiffs purchased the Notes) on the audited and unaudited  
18 financial statements in the 6.5% Notes Offering Memorandum when purchasing  
19 the 6.5% Notes in the 6.5% Notes Offering. Had Plaintiffs been aware of the true  
20 facts, they would not have purchased the 6.5% Notes.

21 202. For purposes of this Count, allegations that Plaintiff HFR read and  
22 relied upon statements in the 6.5% Notes Offering Memorandum refer to Lazard  
23 Asset Management LLC's reading and reliance as agent on behalf of HFR, and  
24 allegations that Plaintiff DPERS read and relied upon statements in the 6.5% Notes  
25 Offering Memorandum refer to Oaktree Capital Management, L.P.'s reading and  
26 reliance as agent on behalf of DPERS.

27 203. Morgan Stanley's conduct constitutes the making of negligent  
28 misrepresentations under applicable state law. As a direct and proximate result of

the negligent misrepresentations by Morgan Stanley, and in reliance thereon, Plaintiffs purchased 6.5% Notes in the 6.5% Notes Offering and Plaintiffs HFR and DPERS and the funds and client accounts on whose behalf the other Plaintiffs purchased the Notes suffered damages.

**NINTH CLAIM FOR RELIEF**  
**For Violation of California Corporations Code §§ 25401 And 25501**  
**(Against Morgan Stanley Based On False Statements**  
**In The 6.5% Notes Offering Memorandum)**

204. Plaintiffs repeat and reallege each and every allegation above as if fully set forth herein, except allegations that the Defendants made the untrue statements of material facts and omissions intentionally or recklessly. For the purposes of this claim, Plaintiffs assert only strict liability and negligence claims and expressly disclaim any claim of fraud or intentional misconduct. Plaintiffs CNH and AQR do not join in this claim.

205. This claim is brought by Oaktree and all other Plaintiffs who purchased 6.5% Notes from Morgan Stanley in California or who purchased 6.5% Notes from Morgan Stanley on behalf of any funds, accounts or clients located in California (together, the “California Plaintiffs”), against Morgan Stanley pursuant to California Corporations Code §§ 25401 and 25501. The California Plaintiffs’ claims are brought on behalf of 50 or fewer persons.

206. Morgan Stanley sold 6.5% Notes to the California Plaintiffs in the 6.5% Notes Offering pursuant to the 6.5% Notes Offering Memorandum.

207. The 6.5% Notes Offering Memorandum contained untrue statements of material fact, including, but not limited to, the audited and unaudited financial statements of ShengdaTech.

208. Morgan Stanley owed a duty to the California Plaintiffs to make a reasonable and diligent investigation of the statements contained in the 6.5% Notes Offering Memorandum to ensure that the statements were true and that there was no omission to state a material fact required to be stated in order to make the

1 statements contained therein not misleading.

2 209. Morgan Stanley did not make a reasonable investigation of the  
3 statements contained in the 6.5% Notes Offering Memorandum, and did not  
4 possess reasonable grounds for believing that the 6.5% Notes Offering  
5 Memorandum did not contain an untrue statement of a material fact or omitted to  
6 state a material fact required to be stated therein or necessary to make the  
7 statements therein not misleading.

8 210. The California Plaintiffs did not know, nor in the exercise of  
9 reasonable diligence could they have known, of the untrue statements of material  
10 fact or omissions of material facts in the 6.5% Notes Offering Memorandum when  
11 they purchased or acquired the 6.5% Notes in the 6.5% Notes Offering.

12 211. By virtue of the foregoing, Morgan Stanley has violated California  
13 Corporation Code § 25401 and Morgan Stanley is liable to the California Plaintiffs  
14 pursuant to California Corporation Code § 25501 with respect to the California  
15 Plaintiffs' purchases of 6.5% Notes from Morgan Stanley in the 6.5% Notes  
16 Offering.

17  
18 **TENTH CLAIM FOR RELIEF**  
19 **For Violation of Connecticut Uniform Securities Act § 36b-29(a)**  
20 **(Against Hansen and KPMG HK Based On False Statements**  
21 **In The 6.5% Notes Offering Memorandum)**

22 212. Plaintiffs repeat and reallege each of the allegations set forth above as  
23 if fully set forth herein.

24 213. This claim is brought by CNH, AQR, and all other Plaintiffs who  
25 purchased Notes in the 6.5% Notes Offering on behalf of any funds, clients or  
26 accounts located in Connecticut, (together, the "Connecticut Plaintiffs") against  
27 Hansen and KPMG HK pursuant to Connecticut Uniform Securities Act § 36b-  
28 29(a). This claim is brought on behalf of 50 or fewer persons.

29 214. Although ShengdaTech is not a party in this action, ShengdaTech  
30 offered and sold the 6.5% Notes in the 6.5% Notes Offering by means of untrue



1 statements and/or omissions to state material facts in the 6.5% Notes Offering  
2 Memorandum, in violation of Connecticut Uniform Securities Act § 36b-29(a).

3       215. Hansen and KPMG HK materially assisted ShengdaTech in selling  
4 the 6.5% Notes in the 6.5% Notes Offering. Hansen audited ShengdaTech's 2007  
5 Financial Statements and consented to the inclusion of its unqualified audit  
6 opinions on the 2007 Financial Statements in the 6.5% Notes Offering  
7 Memorandum. KPMG HK audited ShengdaTech's 2008 and 2009 Financial  
8 Statements and consented to the inclusion of its unqualified audit opinions on the  
9 2008 and 2009 Financial Statements in the 6.5% Notes Offering Memorandum.  
10 As set forth above, ShengdaTech accessed the United States capital markets via a  
11 "reverse merger" transaction, a process that allowed ShengdaTech to sell its  
12 securities publicly without undergoing the due diligence typically performed by  
13 underwriters in advance of an initial public stock offering and without significant  
14 vetting by investors. Because of this, the role of Hansen and KPMG HK as  
15 ShengdaTech's outside auditors assumed special importance, as their audit  
16 opinions were the primary safeguard against financial fraud at ShengdaTech. The  
17 inclusion of Hansen's and KPMG HK's unqualified audit opinions in the 6.5%  
18 Notes Offering Memorandum materially assisted ShengdaTech to offer and sell the  
19 6.5% Notes to the Connecticut Plaintiffs.

20       216. Hansen and KPMG HK should have known, through the exercise of  
21 reasonable care in performing their auditing duties, that the Company's financial  
22 statements in the 6.5% Notes Offering Memorandum were materially false and  
23 misleading and that, therefore, Hansen's and KPMG HK's unqualified audit  
24 opinions on those financial statements were also materially false and misleading.

25       217. Hansen and KPMG HK owed the Connecticut Plaintiffs a duty to  
26 make a reasonable and diligent investigation of ShengdaTech's financial  
27 statements and their own unqualified audit opinions in the 6.5% Notes Offering  
28 Memorandum, to ensure that they did not contain untrue statements of material fact

1 or omit to state material facts required to be stated therein or necessary to make the  
2 statements therein not misleading.

3 218. As alleged in detail herein, Hansen did not make a reasonable  
4 investigation of the 2007 Financial Statements or its unqualified audit opinion  
5 thereon and did not possess reasonable grounds for believing that the 2007  
6 Financial Statements and its unqualified audit opinions thereon did not contain an  
7 untrue statement of a material fact or omit to state a material fact required to be  
8 stated therein or necessary to make the statements therein not misleading. KPMG  
9 HK did not make a reasonable investigation of the 2008 and 2009 Financial  
10 Statements or its unqualified audit opinions thereon and did not possess reasonable  
11 grounds for believing that the 2008 and 2009 Financial Statements and its  
12 unqualified audit opinions thereon did not contain an untrue statement of a material  
13 fact or omit to state a material fact required to be stated therein or necessary to  
14 make the statements therein not misleading.

15 219. The Connecticut Plaintiffs purchased 6.5% Notes in the 6.5% Notes  
16 Offering based on the 6.5% Notes Offering Memorandum. The Connecticut  
17 Plaintiffs did not know, nor in the exercise of reasonable diligence could they have  
18 known, of the untrue statements or omissions of material facts in the 2007, 2008 or  
19 2009 Financial Statements or in Hansen's and KPMG HK's unqualified audit  
20 opinions in the 6.5% Notes Offering Memorandum.

21 220. The material false statements and omissions in the financial  
22 statements and audit opinions in the 6.5% Notes Offering Memorandum  
23 proximately caused the Connecticut Plaintiffs to purchase the Notes in the 6.5%  
24 Notes Offering and proximately caused the Connecticut Plaintiffs and/or the funds  
25 and accounts managed by the Connecticut Plaintiffs to suffer damages.

26 221. By reason of the foregoing, Hansen and KPMG HK are liable to the  
27 Connecticut Plaintiffs for violations of Section 36b-29(a) of the Connecticut  
28 Uniform Securities Act.

**ELEVENTH CLAIM FOR RELIEF**  
**For Violation of Connecticut Uniform Securities Act § 36b-29(c)**  
**(Against KPMG International And KPMG USA, Based On KPMG HK's**  
**False Statements In The 6.5% Notes Offering Memorandum)**

222. Plaintiffs repeat and reallege each of the allegations set forth above as if fully set forth herein.

223. This claim is asserted by the Connecticut Plaintiffs against KPMG International and KPMG USA pursuant to Section 36b-29(c) of the Connecticut Uniform Securities Act. This claim is brought on behalf of 50 or fewer persons.

224. As alleged herein, KPMG HK violated Section 36b-29(a) of the Connecticut Uniform Securities Act by materially assisting in the offering and sale of 6.5% Notes in the 6.5% Notes Offering pursuant to a 6.5% Notes Offering Memorandum containing material false statements and omitting material facts. The Connecticut Plaintiffs purchased 6.5% Notes in the 6.5% Notes Offering pursuant to the 6.5% Notes Offering Memorandum and suffered damages as a direct and proximate result of KPMG HK's violations of Section 36b-29(a).

225. As alleged herein, KPMG International and KPMG USA directly or indirectly controlled KPMG HK. As such, they are each jointly and severally liable to the Connecticut Plaintiffs pursuant to Section 36b-29(c) of the Connecticut Uniform Securities Act, with and to the same extent as KPMG HK, for KPMG HK's violations of Section 36b-29(a) of the Connecticut Uniform Securities Act.

226. KPMG International and KPMG USA are not entitled to a "good faith" defense, because they cannot establish that they did not know, nor in the exercise of reasonable care could they have known, of the facts giving rise to KPMG HK's liability under Section 36b-29(a).

**IX. PRAYER FOR RELIEF**

**WHEREFORE**, Plaintiffs demand judgment on their behalf as follows:

A. Awarding compensatory damages to Plaintiffs HFR and DPERS and the funds and client accounts managed by the other Plaintiffs, against all

1 Defendants, jointly and severally, in an amount to be determined at trial, together  
2 with prejudgment interest at the maximum rate allowable by law (except that  
3 Plaintiffs CNH and AQR do not seek an award of compensatory damages against  
4 Morgan Stanley);

5 B. Ordering Morgan Stanley to disgorge to Plaintiffs HFR and DPERS  
6 and the funds and client accounts managed by the other Plaintiffs (other than CNH  
7 and AQR) the fees and other benefits it received in connection with the 6.5% Notes  
8 Offering;

9 C. Awarding Plaintiffs the costs of this suit, including reasonable  
10 attorneys' and accountants' and experts' fees and other disbursements; and

11 D. Awarding Plaintiffs and the funds and client accounts managed by  
12 Plaintiffs such other and further relief as this Court may deem just and proper.

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**X. JURY TRIAL DEMANDED**

Plaintiffs demand a trial by jury.

Dated: November 21, 2012

/s/ Gary R. Goodheart  
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